(Continued from front flap)

that the tariff is a sales tax paid by the consumer through the retailer, directly to the producer, without the intervention of any public agency;

that the theory of a balanced budget to maintain high production and high employment by deflation of prices and wages is almost everywhere rejected;

that the corporation tax is an evil tax and it should be abolished;

that private enterprise is the twin of responsible individuality;

(to name only some of his major observations), you will find every question he raises of vital importance to you, whether as businessman, investor, consumer, employee, or taxpayer.

Has the Board of Directors become an inadequate instrument of power? Does profit-sharing produce effective efforts on the part of management? How can we encourage greater equity investment in business rather than loan investment? Should any limits on individual compensation be imposed? Are tariffs better, or worse, than direct subsidies as a means of giving protection to our industries which face foreign competition?

Beardsley Ruml discusses these questions that challenge the consideration of business leaders whose decisions affect the welfare of millions of workers and consumers. It can be read with enjoyment and understanding by all, because of the many modern problems it considers. It "makes sense."

TOMORROW'S BUSINESS

TOMORROW'S BUSINESS

BY BEARDSLEY RUML

FARRAR & RINEHART, INC.
NEW YORK TORONTO

This book has been manufactured in accordance with paper conservation orders of the War Production Board.

PRINTED IN THE UNITED STATES OF AMERICA
BY J. J. LITTLE AND IVES COMPANY, NEW YORK

CONTENTS

1

THE ASPIRATION FOR FREEDOM

PRELUDE and THEME

THIS is a book about business as an instrument of authority and power, as a source of direction and decision. It looks at business as one rule-maker among many rule-makers, providing in part the pattern of organization and activity in which each human life takes form.

Most businessmen look on their businesses as profit-making, productive enterprises and ordinarily do not think of themselves as rule-makers or of their businesses as rule-making agencies. But since, in fact, these businesses are both producers and rule-makers and must be run as both, they should be understood as both.

And so this book about business becomes a book about power, the power to make rules and to enforce them. Rules and rule-makers are necessary to order and, therefore, to human freedom. Business as a rule-maker, accordingly, stands high in responsibility among human institutions, as a source of goods and services, to be sure, but also as a source of order and of freedom.

I

The Attainment of Freedom

1. The New Struggle for Freedom

THE place of business and of business rule-making in a country dedicated to the advancement of human freedom can be understood only if first we know what freedom is and understand the conditions that contribute to its greater attainment.

For a long time in ordinary everyday affairs, human freedom has been taken for granted in the land of the free. In principle, the dignity of the individual was accepted as a matter of course. But word-of-mouth acceptance of doctrines pertaining to human freedom and the relegation of its protection to the courts, left us insensitive to practices by which these doctrines were being undermined. World War II has aroused us to the dangers in this neglect, and the doctrines on which human freedom rests have taken on new strength and new meaning everywhere.

World War II will someday be classified with World War I, the Russian Revolution, the French Revolution, and the American Revolution as an important point along the way. But even today we can feel with some

assurance that we know both the place at which we have arrived and the direction in which we are moving.

We are moving slowly toward the emancipation of the human spirit, the attainment of personal responsibility through freedom, and the recognition of the dignity and worth of each human person.

In September, 1939, we passed the point when the deadly challenge was made, the challenge of force to justice, of bestiality to humanity. We have seen the challenge accepted by the United Nations in the name of humanity and justice. The battle was joined, not only in the dimensions of the earth, but also in mind and spirit. To our great advantage, our enemies made explicit their creed of force, violence, and the degradation of men. We made our denials.

The freedom-loving nations were as little prepared for the moral struggle as they were to withstand the sharp edges of the blitz. They reached back into their honorable traditions and found good doctrines which they put to use. These doctrines were dusty but in excellent condition, and they proved to have the power to inspire men to effort and sacrifice.

The comprehensive and explicit blasphemies of the Axis could have been denied only in equally comprehensive and explicit terms. And this denial turned out to be the affirmation of Christian insights of great antiquity, and of the essential humane doctrines of the American and French revolutions. The ambiguities and pedantry of World War I, and of the Russian Revolution, dropped into place before the sweep and clarity of this new conflict for the possession of the human soul.

The ancient doctrines of freedom were proclaimed by the leaders of the freedom-loving nations. The heat-of-war violence and the early searchings of doubt as to victory gave to these doctrines a life and urgency which transcended the casuistry of political and literary formalism. The conditions of men in the freedom-loving nations have already begun to be tested against these ancient and new living doctrines.

Whatever the future may bring, for the moment the humane ideals of the Christian, American, and French revolutions have become active, official doctrine, espoused positively in the denial of the Axis creed of human degradation, and accepted by hundreds of millions throughout the world as the justification for sacrifice.

With victory some of our leaders may become less vocal about human dignity and freedom. But if some become less vocal, others will become more so. The people will continue to believe that the true road leads toward freedom; and, with ups and downs, the people will follow according to their understanding and their intuitions.

2. *The Impulse to Freedom*

For us in the United States, but not for us alone, the word "freedom" comes down the years as a rallying cry for effort and sacrifice, as an organizing principle of human faith and aspiration. From time to time, freedom

has been the central issue in conflicts about religious worship, governmental forms, political parties, human labor, industrial organization, education, race, caste, and the circumstances of birth. Freedom finds its place as "liberty," and in the Declaration of Independence as an "inalienable right." The battle cry of freedom was raised in our Civil War in the last century. Today the Four Freedoms—freedom of worship, freedom of expression, freedom from fear, and freedom from want—set the elementary goals of the freedom-loving nations everywhere in the world.

The insistent demand for freedom has cracked open religious institutions, upset dynasties, inspired revolutions, and armed tens of millions of men and women in its defense. With victory, the will for freedom must inevitably become a matter of substantial importance for rule-makers of all kinds, in state, church, home, trade union, and business. For business, the will for freedom will transcend the conveniences and the efficiencies of imposed methods of production and distribution, if these methods are inconsistent with prevailing ideas of what freedom ought to be.

What is freedom? For what is freedom so much desired?

The meaning of freedom has varied from time to time, and the purpose for freedom changes with the predilections of him who invokes it to sustain his cause. For some and at some times, freedom has meant the condition of man in a state of nature. For others, at the opposite pole, it has meant a range of human activity restrained only by the dictates of reason. At times, freedom seems to

imply mere equality under the law. At other times, freedom asserts the elevation of human rights to a position above man-made statutes.

Today we have our contemporary concept of what freedom is and what it is for. Today what people want when they demand freedom is a condition under which they can realize, with reasonable completeness, the potentialities as persons that inhere in their capacities as individuals. The demand for freedom is a demand for fulfillment, for growth, for life—not in the material or biological area alone, but also in the realm of mind and spirit.

Just as different animals and different plants require different foods and temperatures and ways of movement for their unfolding, so different individuals find different circumstances helpful, indispensable, or irrelevant to the meeting of their needs. And just as plants and animals of the same species have common irreducible necessities for their growth, so, too, do human beings have in common minimal conditions for the realization of the fullness of themselves as persons. These minimal conditions define the common content of freedom, and as our knowledge of what is useful and good for human development grows our conception of freedom grows along with it.

Since the demand for freedom is a demand for conditions that favor the achievement of full richness of personality and individuality, the specifications necessarily change from time to time and from person to person. It is for this reason that so little is required by many, and so much by a few. The demand for freedom reflects the

culture of time and place and person, the things that seem worth while, and the prevailing notions as to the nature of personality. But, within an existing system of values, the individual human animal will fight for his freedom as he would fight for his life; indeed, it is his life for which he fights. Whether the protest against restraint be directed in the area of religious orthodoxy, hereditary autocracy, imperfect suffrage, industrial decisionism, or bureaucratic regimentation, the emotional fury and the reckless disregard of material welfare reveal the struggle for what it is—a fight for survival in which no price is too great to pay to save what has been embraced as the essential core of freedom.

3. *The Feeling of Freedom*

The fight for survival is the impulse to freedom. But to understand freedom itself we must go beyond mere recognition of the impulse. When we go deeper we find that freedom has two distinguishable phases, the feeling of freedom and the fact of freedom. We shall observe that the feeling and the fact of freedom may exist independently one of the other. This separability of fact and feeling causes many misunderstandings about the problem of freedom, since, to satisfy our aspiration for responsible individuality, we must have both. One alone is not enough.

The feeling of freedom is a state of mind. It is a

sense of power to make a choice between alternatives. It is therefore a feeling of power to impose one's own will on the direction of events. The individual feels that his own uncoerced act has made events what they have become, and that he might have made them different had he decided differently.

The basis for the individual's feeling of power lies in his prevision of the consequences for the future that reside in his yet-to-be-taken choice between alternative actions. And it is in the feeling of power and in the feeling of the possibility of power over the course of events that we find the source of awareness of personal dignity and worth-whileness. In this awareness we have the feeling of freedom.

Three conditions are required for the existence of the feeling of freedom. First, in the period of choice, the future must enter into the conscious present as an influence on a decision yet to be made. Second, at the time the decision is being made, the individual must be aware that the decision is being made, and the degree of the feeling of freedom is related in some degree to the keenness of this awareness. Third, the feeling of freedom depends on whether the area of choice is felt by the individual to be adequate for the act. To put it another way, it depends on whether the act is felt to be coerced by circumstances or by the laws of man or of nature.

Let us examine these three conditions for the feeling of freedom in more detail.

The first condition requires that, in the period of choice, the future must enter into the conscious present

as being formative with respect to a decision yet to be made.

To feel free, we must be able to see the consequences of what we are about to do. There is no feeling of freedom in blind choice, nor in decisions made merely to get on from one moment to the next. If we see the future which we are about to influence as a long one, our feeling of freedom has more significance to us than if that future is short. If we can see the consequences of our choice clearly, our feeling of power is greater than if the outcome is uncertain or unclear. If the events we determine seem important to us, we feel our free act to be more important than if the events seem trivial. In any case, we cannot feel free unless we are aware of a possible future which our present decision is intended to influence.

The second requirement for a feeling of freedom is that, at the time a decision is being made, the individual must be aware *that* the decision is being made.

People make decisions with varying sense of the immanent act of will. The sense of the act of will must be keen if the feeling of freedom is to be strong. The degree of keenness is lowered by fatigue and by the stress of emotion. It is lowered also by habit; by repetitive decisions, no matter how important, on questions which are familiar and the solution of which has become more or less routine. The human animal would have a hard time making his way in the world if every free decision were accompanied by consciousness of the act of choice. On the other hand, the dark of unconscious adaptation and of depersonalized judgments, expressed under conditions

of fatigue or routine, must be illumined by occasional moments of explicit awareness of responsible choice. Without such moments, there can be no feeling of power and no individual dignity. Clarity of apprehension of the act of will in the moment of decision is necessary if we are to have the feeling of freedom.

Finally, the feeling of freedom depends on whether the area of choice is felt adequate for the act; that is, whether the act is felt to be coerced. All decisions are made within a frame of order. As we shall point out in this chapter, this frame of order is determined by the laws of nature, by habit and custom, and by man-made rules. As long as the desired objective can be attained by the choice of alternatives within this structure, the individual feels uninhibited by coercive restraint. The feeling of freedom will, therefore, exist when the area of choice is wide enough to permit achievement if the correct decisions are made.

The feeling of freedom does not require unlimited discretion. Indeed, without a structure of order, the system of decision becomes amorphous and freedom vanishes. Decision involves a choice of alternatives within a system of pressures that gives rewards and imposes penalties. These pressures give significance to the act, but the act itself remains free. The pressures not only do not limit the sense of individual power, but they define the scope of risk, reward, and penalty. Accordingly, they give meaning to effort, success, and failure in determinations made freely by the personal will.

It follows from these three conditions that the feeling of freedom may exist under conditions of extreme

regimentation and restraint. Once an individual accepts for himself the inevitability and propriety of the human and natural laws that bind him, once he limits his aspirations to achievements that can be had by successful decisions among alternatives within this frame, his feeling of freedom may be complete. All that is needed beyond this is present awareness of a future which is attainable, and clear consciousness in the moment of decision.

For this reason, the feeling of freedom is not enough. Unless the fact of freedom is associated with it, the feeling of freedom can become, in the hands of the ambitious, an instrument for the degradation of their race. The illusion of freedom without the reality will be unstable, since, sooner or later, new leadership will arise to release the basic impulse to freedom. If such leadership does not arise from within, it will penetrate from without—today more easily and rapidly than ever before. Then, through education, compromise, or revolution, the march toward freedom will be resumed.

4. The Fact of Freedom

The feeling of freedom, being a state of mind, is largely determined by inner, subjective influences. The feeling of freedom exists authentically for one person under circumstances that would cause another to feel enslaved.

The fact of freedom, on the contrary, exists in the relations of the external world of things, persons, and events to the individual. As we have said, freedom is a condition in which people can realize with reasonable completeness the potentialities as persons that are inherent in their capacities as individuals. Obviously, these conditions are not the feeling which an individual may have about his world, satisfied or dissatisfied though he may be.

The individual cannot know completely the conditions that are necessary to assure him the fact of freedom. He may know, in part, the range of potentialities that are inherent in his capacities, and he may have some notion as to the circumstances that are required in order that he may achieve them. But he does not know all, nor can he. Nor are there experts who can specify the extent of possible human advancement. The sciences of physiology and psychology are incomplete and, in spite of great progress which can be expected in the future, they will doubtless remain so. The best that can be done is to draw on the intuitive and scientific wisdom that is at hand, and to establish in our society the institutions and practices which will give the known conditions for the fact of freedom. As our wisdom grows, the established conditions for the fact of freedom must grow as well.

Three conditions determine the extent to which the fact of freedom exists.

The first condition is a healthy and developed body and mind to serve as instruments of the will. The second requirement is the opportunity for responsible choice,

for making the decisions through which the unfolding of the personality can in fact be achieved. And the third requirement is that the individual must have access in large measure to the natural world, to climates, soils, minerals, and seas, and to a normal human society of which he is a part.

First of all, a healthy and developed body and mind are indispensable if the will is to be well served. Many of the essential conditions for proper development of body and mind must be established in infancy and early childhood. The individual must learn to eat what is good for him, and he must have the opportunity to do so. Useful habits and skills must be acquired. He must be able to use a language, to speak, to write, and to read. A man who is illiterate cannot realize his potentialities, and therefore he is not free. A man who knows only one language is less free than one who knows more. He must have facility with the use of numbers. He must be at ease with ordinary social usage so that he can manage the conventionalities that will give him access to the social world which he needs to become a person fully himself.

The requirement of a healthy and developed body means the protection of the individual from accident and disease. It means equal access for all to resources for the repair of bodily injury and the treatment of sickness. It means a minimum of food and shelter, particularly for growing children. The meeting of these requirements is a matter of concern for the people acting together as a whole, since today the inability of an individual to do all these things for himself comes in large measure from the division of labor and the specialization of modern pro-

duction. This specialization has greatly increased our capacity to produce, and we have encouraged it. It is appropriate that some portion of our large aggregate production should be set apart to make sure that freedom is possible for all, at least in so far as freedom depends on healthy bodies.

The requirement of a healthy and developed mind is no less important than that of a healthy body. Here the influence of the home, the school, and the church will be crucial. The role of the political party, the social club, and the trade union will also be important in enlarging or limiting the mind of the individual as an instrument for his freedom. As citizens, we want each of these agencies to promote reason and to reduce ignorance on the part of the people over whom they have influence. We want to restrain them when their leaders reach for power through the exploitation of ignorance, prejudice, and superstition, evils which are inconsistent with a strong and healthy mind.

Our second condition for the fact of freedom is that of presenting the individual with events and issues where there is both opportunity and necessity for responsible choice.

Let us see what this condition has to do with the fact of freedom. Clearly, a healthy body and a mind of reason are nothing more than the instruments which make freedom attainable. Freedom itself resides in the act of will; and the value in freedom is the growth of the individual person through acts of will in moments of decision involving responsible choice. The fact of freedom is not attainable in a world in which there are no decisions to

be made. The opportunity for full realization of what is potential in a personality depends vitally on the nature and scope of the situations in which the individual acts responsibly.

Acts of decision, to be of value for the growth of character, need not be "important" acts in a public or historic sense. Many authentic choices of a minor character are more fruitful for personal development than are the grand decisions in which the pressure of events and the numbness of conscience produce an automatic and meaningless response. The decisions that count are those in which the individual feels himself free, and for which he is prepared to be judged.

Not only must the individual feel free, his act being consciously his own, but the consequences of the act must be subject to moral, intellectual, or aesthetic evaluation. Was the act good or evil, wise or foolish, beautiful or ugly? These questions make decision difficult, and, as a result, freedom is sometimes a burden.

At this point we touch the heart of the conflict between the feeling of freedom and the fact of freedom. When decision is difficult, when evaluation is inescapable, then evasion and compromise rise up, and the act of will for which freedom exists is set aside. The feeling of freedom may be well-fulfilled in choosing evasion rather than decision. And the opportunity to evade must exist to give to the act of will its moral value.

But if the choice made is the decision to avoid the need for choice, then the feeling of freedom has become parasitic on the fact of freedom, and freedom as an instrument of human fulfillment is dead.

The third condition for the fact of freedom is access to the natural world. Given all the other conditions, unless the richness of nature is at hand within the area of choice, the unfolding of human talents will be restricted. The material and social world, as it presently exists, sets the boundaries of external stimulus and inspiration.

No one person, to be sure, will have the full measure of his contemporary world at his disposal. But most people could have more of it than they do have if it seemed to them important to make the effort to get it. Everyone can share vicariously in a world larger than his own through the medium of the arts. Never before has so rich an experience been possible to so many people. The arts, the sciences, and commerce have opened doors which for our fathers were closed. In this fact, our generation has an unparalleled opportunity for freedom, but even this opportunity will seem meager to the generations which follow us.

Why should the fact of freedom be set beside the feeling of freedom, equal with it and indispensable? What importance has the fact of freedom to one who feels himself free? Whose business is it? Why should people—why should I, myself, carry an unwelcome burden in the fact of freedom if I can feel free within whatever binds me? And, particularly, if others do not want for themselves the fact of freedom, why should I assume any responsibility for them or for the conditions of their voluntary life? Let me alone with my own freedom to achieve my own dignity!

There are two answers to these questions. First, no man can be free in a company of slaves, however well-

contented they may be. He cannot be free because they will not permit him to be free. His words and acts will be a constant irritation to the easy conventions and superstitions of the mob and of its leaders. Having no conscience and no faith in human dignity, the unfree will restrain the free by violence if they are powerful enough to do so. Accordingly, the choice for the free is either to assume responsibility for securing the fact of freedom for all or to amass the force necessary to secure his own freedom against the unfree.

In the second place, it is good that other men should be able to achieve, for themselves, the fullness of personal development and responsibility which one desires for oneself. It is good that they should have this opportunity, whether they wish it or not; and they must not prevent others from enjoying it, even by persuading them that they do not want it. The justification of our aspiration for freedom lies, in part, in our purpose to bring freedom to others and to contribute, in the measure of our own capacity, to the emancipation of the human spirit everywhere.

5. *Order and Consent*

We are interested in business as a rule-maker, not because we are interested in business, but because we are interested in freedom. Freedom must be found in a world of many rule-makers. Rule-making, when it is effective, imposes controls on the course of events. As a

result of these controls, some things are permitted to be done and other things are not. Next time, while the rule lasts, the thing done will be the same. The result of rule-making, therefore, is order—the ordering of our expectations.

We live in an orderly universe. The only unorderly element in it is the human will. There are some who do not believe in human responsibility or in the possibility of freedom. They include the human will with the rest of the universe, as determined exclusively by the impersonal laws of nature. For them there is no freedom, only order; only the illusion of freedom; no men, only animals.

The point is a crucial one for philosophers and statesmen. It is dividing the world in a holy war. It must not divide us. We must act on belief in human responsibility and the possibility of freedom in a world of order.

The order of the universe comes from three sources: (1) natural law, (2) habit, and (3) the rules of governments. Natural law gives us day and night, the four seasons, rain in summer and snow in winter, the energy in oil and the nutriment in grain, the two-day recurrence of fever in tertian malaria. It gives us the generations of men and the instincts of men, the compulsions of anatomy and physiology. It gives us the possibility of habit.

Habit is order imposed on protoplasm. The capacity of protoplasm to acquire habits comes from its nature, from natural law. The habits which it acquires, it acquires from its environment.

Habits may be acquired by plants, animals, and men. Wind, rain, and sun will affect the pattern of move-

ment of branches and leaves. The training of horses for work and for amusement is the adaptation by habit of the inner animal to the outer world.

The habits of a man, like those of an animal, are order imposed on an already ordered protoplasm. Note the structure of man with legs and arms, and neither tail nor wings; the tensions, hungers, and sluggishness of his body; the sense organs he has, and those he has not; the endowment of organization in nerve, bone, and muscle, resulting in reflexes, instincts, and special talents and sensitivities. These are the orderings and the limitations of his nature.

Habit follows nature, superimposing order upon order. From the moment of birth, and before it, adaptation to the outer world begins. As adaptation continues, as the same situations occur over and over again, the response becomes certain, efficient—and unconscious.

Our behavior is ordered in part by our natural endowments, in part by habit, and in part by conscious choice, according to the uniformity and the frequency of particular experiences. But, fortunately for us, we are not required to pass attentively over the same ground, over and over again. Habit steps in to relieve us of that burden.

After natural law and habit, the rules of the rulemakers give additional form and certainty to our expectations. When rules are wise, they are consistent with natural law. After rules have been operative for some time, they are assimilated and made effective as habits. When they have become habits, they seem as natural as natural law itself.

Rules differ from habits in that they always have their origin, at some time—perhaps long ago, in the decision of a rule-making agency. Rules are the pronouncements of the human will for the control of the human will. They display the insight and blindness, the generosity and greed, the care and carelessness of the human source from which they came.

The order arising from natural law, habit, and the rules of rule-makers gives us such certainty as we possess concerning expectation of the future. Certainty of expectation is indispensable to the exercise of freedom. Our decisions and our choosings always relate to actions whose outcome is in the future. We must have some assurance that if we decide one way, the outcome will be so; if we decide the other way, the outcome will be another. Without order in the universe, there could be no such assurance; and without assurance, without prevision of the consequences of choice, freedom of choice is meaningless. Freedom and chaos are incompatible.

The fact of order in the universe does not, therefore, preclude freedom, it gives freedom its moral significance.

Judgment as to the moral worth of any pattern of certainty rests on two considerations: (1) does the area of choice within the frame of order give scope to the unfolding of the intrinsic natural personality, and (2) are the compulsions which shape the structure of order acceptable to the individual as necessary, desirable, and valid? The fact of freedom depends on the first consideration, the feeling of freedom depends on the second.

The operations of natural law are generally accepted

as limitations to which we must accommodate ourselves. But we need not conform to these limitations with complete docility. We can fight natural law with natural law. A lens can help us see, an electric current can help us hear. We have no wings, and yet we fly. We have quinine, and the recurrent chills and fever of malaria do not recur. For most of us, the limitations arising from natural law appear necessary and valid, and we do not raise the futile question whether they are desirable or not. The intrepid and dissatisfied scientist and inventor sees in these limitations a challenge and solves the problem, using natural law to his purpose. We all gain by this extension of our area of choice, not necessarily in the feeling of freedom, but in the fact of it—since through activity and experience we can become what otherwise we might never have been.

Consent to the existing structure of order is necessary to the feeling of freedom; and without the feeling of freedom, choice is irresponsible and the growth of individuality inconceivable.

Most people accept the order of the world that comes from natural law and habit. But the rules of the rule-makers, if they are unwelcome, seem less necessary. They are man-made orders for the ordering of men. To be acceptable when they are imposed, they must be valid; they must be imposed with the consent of the governed. Minorities must concur, at least for the time being, in the decision of majorities. Otherwise, even though the laws of men be necessary and desirable in the building of order and certainty, they are unacceptable in a free society since they have been imposed by one will upon

another will, without the latter's consent and without acquiescence in their essential validity.

The consent of the governed is sometimes consent to the rule itself, but, more often, it is consent to the rule-making of some recognized authority which decides what seems best. Ordinarily, we cannot know enough about the complicated issues and essential facts to know, for ourselves, whether or not a rule is proper. We must depend on those who make the rules to study the whole situation and to legislate and to administer fairly in the best interests of all. Rule by consent is usually consent to the rule-maker's authority, and from this follows, naturally, acquiescence in the rules themselves.

In the United States we want our national government to foster order and to protect freedom. We are also well-adjusted to our many public and private rule-making agencies, our states and cities, our homes, churches, trade unions, and businesses. The delegation to each of its proper sphere of control relieves us from uncertainty, and gives us room of our own to breathe in. We expect from each of these governments—each in its own sphere—order and certainty. But we also insist that order will not be imposed at the cost of freedom. To protect us against this danger we have our national government, our Constitution, and our declared individual rights. We expect the national government to intervene if subordinate public and private governments clumsily or maliciously infringe our basic rights.

What does this mean for business? Business must be rule-maker to do the job it is the business of business to do. Business must bring order and certainty to the pro-

duction of things for use, to the providing for people of useful things to do, to the making of a place where savings can be invested. But, like other governments of which it is one among many, business must not attempt to achieve order and certainty at the cost of the freedom of those whom business governs.

Like any other rule-maker among us, business must preserve for the governed an adequate area of choice, and must administer its rules in an atmosphere of consent. Then business will be associated harmoniously in the pattern of controls for freedom.

6. *The Attainment of Freedom*

Our study of the conditions for the feeling of freedom and for the fact of freedom makes it clear that human freedom in an absolute sense can never be attained. Freedom will always be relative, a matter of "more or less." The life impulse to freedom will constantly drive toward "more" and away from "less," even though it be toward a goal which constantly recedes as it is approached and is better understood. There can be no day when it will be said that human freedom has been finally won. Accordingly, we strive, not for a moment of victory that will divide the past from the future—the dark from the bright, but for an expanding opportunity for each and all of us to grow over the years in human stature. The obstacles along the way are ignorance, superstition, and

the love of arbitrary power. These obstacles can be minimized by science and education, by spiritual insight revealing the worth and dignity of man, and by a rule of order established and administered with the consent of the governed.

In the United States, the dominant governing power —the national state—is committed fundamentally to the ideal of human freedom. It is committed by the declaration of its independence, and by the bill of human rights which reserve to the individual liberties which even the dominant governing power may not infringe. Its history, its internal dissensions, its conflicts with external national powers—all confirm the constant, if irregular, march toward the goal which inspired its beginnings. The ideal of freedom is not merely a statement expressed in various forms in declaration, constitution, and the speeches of public leaders; but it is deeply embedded in the mind and culture of the people. The obvious imperfections in our attainment of this standard are overwhelmingly regarded as deviations from a norm, and not as the repudiation of the ideal. And, generally speaking, the country is committed to the elimination of these imperfections as rapidly as education, insight, and the orderly processes of rule by consent permit.

In a country like the United States, so deeply committed to the ideal of human freedom, the various subordinate governments—public and private—must conform in their own rule-making to the ideal of human freedom. Imperfections and inadequacies are tolerated, but they are not excused. Repudiation of the ideal of freedom is neither tolerated nor excused. The states and cities may

not legally infringe the rights of the people. The private governments—church, family, trade union, and business—will increasingly be judged by the aid they give to the struggle for freedom. Even today these private governments may not impose, on those they rule, ignorance, disease, and bodily injury as means of achieving their private purposes.

As the rule-making functions of church, family, trade union, and business are better understood and more generally accepted for what they are, these private institutions will test their rules against the standard of conditions required for individual growth and development; and each in its own way will come into greater conformity with the supreme ideal in promoting the attainment of human freedom.

2

BUSINESS AS PRIVATE GOVERNMENT

II

The Business of Business

1. What Is Business?

BUSINESS is one of the most pervasive facts of modern life. Practically everybody who lives in a city, town, or village does business with business several times a day, and practically everybody else has something to do with business many, many times in every year. We depend on business for the things we eat and wear, for the home we live in, for most of our amusements and recreation, for going places and knowing what is going on in the world. Most of us depend on business for the kind of jobs we have. Many of us own some part of a business or receive some income from lending business our savings. Business is so common that we take it for granted and use it without thinking much about it—just as we do any other familiar facility. And yet, even though we do not give much thought to business in general, because of this pervasiveness of business in modern life, business is important in its relation to most people, not only because of what it does *for* them, but because of what it does *to* them as well.

In order to understand the part that business plays in life and the part it is likely to play in the future, we must have a clear idea of just what business is, of the things that business does, and of how business operates to achieve the things that business is for. After that, we can think about the ways that business helps or hinders us in the attainment of personal dignity and freedom.

What is business? Some organizations are clearly business organizations and their activities are clearly business activities. They cover a wide range. They include the New York Central Railroad Company, and Pan American Airways; New Jersey Zinc, and Homestake Mines; Sterling Products, and Campbell's Soup; Sears-Roebuck, and Macy's; Columbia Broadcasting, and Western Union; Irving Berlin, Inc., the Shuberts, and Arthur Murray; J. P. Morgan & Co., and the Bank of Italy; Farrar & Rinehart, and *The New York Times*—these, and others like them in these and other fields, a few larger and many smaller and smaller. The proprietor of a one-man store or the independent salesman working on commission we would certainly classify as being engaged in business activities even though he be a single person.

Some organizations are clearly not business organizations. They include Harvard University, and Vassar College; The United States Post Office, and the Port of New York Authority; the Federal Council of the Churches of Christ in America; the International Ladies' Garment Workers; and the Republican party. Although these organizations may be businesslike in their operations, they are not businesses.

When we come to professional people and farmers we are not so sure. There is a doubtful zone that contains many organizations and activities which are hard to classify, such as Sullivan & Cromwell, the lawyers; Farmer Brown, the farmer; Ford, Bacon & Davis, the engineers; Dr. Smith, the doctor; Touche, Niven & Company, the accountants; Harrison, Fouilhoux & Abramovitz, the architects.

From these examples of what *is* business and what *is not* business we can observe common qualities which exist to a greater or less extent in every business. A business consists of an organization of people with varied skills which use property or talents to produce something which can be sold to somebody for more than it costs. The profit of this operation, after paying taxes, belongs to private individuals, who, in one way or anther, have a legal claim on it. A business may or may not be a corporation, although most business today is carried on in the form of a business corporation whether in fact it is one or not.

Starting with this idea of what "a" business is, the general word "business" may be used to refer to all businesses taken together. Business is more than a simple sum of separate units. Business includes not only all the separate units of business activities, but in addition it consists of the many relations of the units, one to another. Business is the aggregate of Standard Oil Company of New Jersey, General Motors, Warner Bros., your shoe store, your neighborhood druggist, and a hundred other activities which furnish us with products and with jobs. It is also a vast, complex set of relationships: technical,

financial, organizational, and human. It cuts deep into vital points of our life, far beneath the surface of dollars and cents transactions. We can see this at once when we ask the questions, "What is the business of business?" "What is business for?", and "What does business do?"

This is the business of business: first, to get things ready for use; second, to provide people with purposeful activity; and third, to give people a way to save productively a part of what they earn.

In saying that business is for these three particular purposes, we do not imply that business is the only way of getting these purposes accomplished, nor are we saying that it is the best way which can be found or which could be devised. We are making a simple statement of fact: this is what business is for and this is what business does. We make this statement of fact without pretentions as to the superiority, immutability, or exclusivity of business claims as to these purposes and functions.

2. *Things to Use*

The first business of business is to get things ready for use. Of course, by "things" we mean both goods and services.

Final use takes place in the hands of the people—in the hands of Mr. and Mrs. I. M. Consumer, their children, and their neighbors. These families use soap and milk, towels and sheets, radios and vacuum cleaners, beds

and tables, apartments and houses, fire insurance and the daily newspaper, and a thousand other things besides. Mr. and Mrs. Consumer and their family use an incredible variety of things, things they could not possibly make for themselves. In most cases they do not know where, how, or even by whom these things are made. They only know where they can be bought—the rest is generally taken for granted.

Before things can be made there must be available the raw materials from which they are compounded. The business of getting these raw materials is carried to the ends of the earth. Some of these products come from the ground, some from the sea, and some from the air. Coal, oil, iron, and copper; bromide and magnesium; oxygen and argon; tungsten, platinum, and diamonds—such is the range and variety of the raw material industries. Rubber, copra, tea, corn—agricultural raw materials—are largely produced by individuals, the business company assembling and shipping the product from the point where it is grown. Some of these agricultural raw materials, such as rubber and tea, are also produced in large quantities by business enterprise.

The raw material companies in carrying on their businesses have greatly extended our knowledge of the earth's surface and our scientific and practical knowledge of how the earth's products can be obtained. Some of these businesses, as, for example, nickel, copper and aluminum, have shown us new ways in which these natural materials can be used.

Many of the early trading companies, such as the Hudson's Bay Company, were centered around raw ma-

terials. In these companies and their successors, we find our clearest examples of private government. Because of their rule-making powers and necessities, they frequently found themselves so much entangled with the public government with which they were associated that sometimes it was difficult to tell which one was which.

Raw materials must be made into things before they can be distributed. The business of manufacturing is the process of making changes in the form and arrangement of materials of one kind and another. The processing of raw materials requires both fundamental and practical knowledge with respect to the qualities of raw materials and the application to them of natural forces, such as heat and power. Manufacturing also requires skill in organization, the building up of a trained and integrated working force, with procedures for timing, testing, and inspecting the work as it moves along.

The business of manufacturing has preserved for us a considerable part of the practical knowledge that has come to us from the past, and in the case of secret processes, this knowledge is available to us only in this way. Manufacturing has greatly increased the store of practical wisdom about nature, and in recent years has made increasingly important contributions to fundamental science. The characteristic activity of the progressive manufacturing business has been to search out the intellectual products of the scientific laboratory or the inventor and to find ways of bringing out these ideas in practical application in commercial products for ordinary use. The radio, the automobile, the camera, and the airplane are striking examples of the adaptation of scien-

tific knowledge to common use by business activity. But there are innumerable, humbler examples: soap and shoes and razor blades, and the reproductions of works of art which are now available at little cost.

The manufacturer must judge in advance what people will someday want. The manufacturer's judgment is expressed in his investment in his plant, in machinery, and in the design of the product that he thinks people will use if he makes it for them. Ordinarily, the articles themselves are not made in large quantities until after some distributor has made his own decision as to what these future wants will be and has placed his order with the manufacturer. This relation between the distributor and the manufacturer is an essential part of the fabric of business and is an indispensable element in the operations of business in getting things ready for use.

Even after having been provided and fabricated by the manufacturer, the goods of commerce are still a long way from practical use. Another segment of business, the business of distribution, now makes its contribution by taking something which has already been made and changing its location in time and space. Position in time and space makes a tremendous practical difference in whether or not an article is ready for use. It is not ready for use unless it is at hand when it is wanted. It is the business of distribution to see that things are *where* they are wanted *when* they are wanted. The activity of arranging so that things have their proper time and space positions, ready for use, involves a considerable proportion of business activity as a whole.

In order to get things ready for use, the articles that

will be wanted at some future date must be found and selected from a wide range of present possibilities. The articles selected must then be held on hand until they are needed, and during this time they must be kept in good condition.

Next, these articles must be ready for inspection. This means a place of doing business and a way of showing what is ready for use.

The articles must be priced. Usually the pricing is done by the retailer, but this is not always the case.

Finally, the articles must be delivered to a place where they are wanted. Sometimes this place is the retailer's own counter, often it is not.

The businesses we have just discussed—raw material, manufacturing, and distribution—are engaged primarily in getting things ready for use. There is another great group of businesses which we can think of as "utilities." They supply electricity, gas, and sometimes water; they provide transportation by rail, bus, ship, and airplane; they provide for the sending of messages and information by wire and wireless. The insurance companies and the banks fall into this group of service and utility companies which operate under special public franchise and under special public supervision. These utility and service companies have less freedom in the prices they charge and in the quality and character of the services they render than do other businesses. They require the exemption from elements of competition which other businesses are subjected to, and, to the extent that competition is removed as means of regulation, more formal and organized regulation is needed.

Distribution, manufacturing, raw material production, and utilities are served by other businesses whose principal dealings are with business. For example, companies like International Business Machines Corporation, which is engaged in the manufacture of typewriters, accounting machines, etc., are facilitators of businesses which themselves are working more directly for the public. Frequently these servicing companies have split off from the main stem of business and have survived because the specialty lent itself to efficient, specialized development. Testing laboratories, advertising agencies, and mimeographing services illustrate these specialized services which are a part of the business scheme of things.

One important part of the business job of getting things ready for use is to make sure that the people know that the various products and services of business are available, and where and on what terms they can be obtained. A product which has been manufactured and is available for distribution but which no one has heard about is like the bell ringing in the middle of the Sahara that makes no sound since there is nobody there to hear it. A thing is not ready for use until its existence is known.

The means of making known the products and services which business makes available is advertising in its many forms. Although sometimes advertising may increase the cost of things, advertising usually makes it possible to sell things for less. Through increasing the quantity that the people want of a limited range of products and designs, advertising results in a more efficient use

of men and machines. Advertising is an essential part of the business job of preparing things for use.

Through its advertising and promotional activities business is also doing a job of practical education of the people. These activities tend to bring the country into a common pattern of material culture, and, as a result, people know of the existence and use of things which help them do the things they want to do.

A generation ago some of our writers made fun of the fact that millions of Americans eat the same cereals, drive the same cars, see the same movies, and wind the same watches. Today nobody laughs at this. We are beginning to understand the great human values that can spring from having standard goods, services, and processes which are now available throughout the country and which are on the way to becoming available throughout the world. Consider the implications of our soldiers' splitting a case of Coca-Cola with the peoples of Tarawa, Burma, or North Africa, or of having the automobile that was bought in Cincinnati fitted with standard spare parts in Casablanca and driven by a citizen of Cairo.

To say that the first business of business is to get things ready for use sounds like an abstract definition—perhaps too elementary for thoughtful consideration—but when you translate that abstraction into the infinite details of everyday life, you conjure up the world. For business gets ready for use most of the things invented by the brain and fashioned by the hands of man, it makes and distributes the goods and services of our civilization. Getting things ready for use is one of the principal pre-

occupations of life and for this reason, if for no other, business is a matter not only of private interest but of public concern as well.

3. Something To Do

While businesses go about their business of making a profit by making things people want, at the same time they serve two other purposes of great importance: first, they provide people with purposeful activity, with something useful to do; and second, they give people a place where they can invest their savings. Neither of these two purposes is the primary object of the manager of a business. To be sure, the manager of a company ordinarily is pleased if his business is a good one for people to work in. And he is proud if the securities of his business are considered attractive by people who have savings to invest. But the central purpose of the business should be to make a profit by making things people want, and the business was not started nor is it continued in order to give people useful work to do. And, although a certain amount of money has gone into business on its own initiative to seek its own reward, most of the capital of business today is the passive savings of the people who are well-served if business gives them, as an incident to production, a fair rate of return on the money they have set aside.

Nor are these two secondary purposes—a place to

work and a place to invest—served exclusively by business. There are other ways of finding something useful to do, other ways than going into a business. A person can practice medicine, teach school, be a deputy collector of internal revenue, or keep house and raise a family. There are other places to invest money than in business. An investor can buy farm mortgages and government bonds.

But, although it is true that there are other ways than business of getting useful things to do and if providing places where savings can be invested, the fact remains that, as of today and tomorrow, business is the vehicle by which these two ends are reached for a significant part of the people. It may not have been the intention of business to do more than to make things to sell at a profit; however, since in making things to sell at a profit it does do more, we must examine the broader position of business in modern life.

First, let us consider the place of business in providing people with purposeful activity. People, to live normally and healthfully, need something useful to do. It is true that there are examples of individuals who have made indolence a habit and who seem to find in perpetual rest an abiding satisfaction, but the ordinary person who undertakes to live a life with nothing useful to do is likely to turn up in a mental hospital. Even the ascetic and the mystic value the nothing which they seem to be doing as very important and useful indeed. And the beautiful and fragile playboys and playgirls of all ages justify their ornamental activities as providing a sophisticated standard of consumption.

This impulse to constructive activity springs from

sources deep in human nature. We enjoy the experience of creative work in the moment of its being. We take pleasure in contemplating the product resulting from our efforts, whether that product be a thing we have made or helped to make or a reputation for the things we have done.

Most people get most of their feeling of having done useful work from the opportunities which arise day after day in business employment. The tests of utility are perpetual and concrete. The business, of which the individual is a part, is making something that people want enough to buy at a profitable price. This is not boondoggling, no matter what a philosopher might judge by abstract standards to be the value of the work. Every person who participates in the performance of that business participates in the creating of something for use.

Since the human need for the feeling of sharing in useful work is so great and since the fact of sharing in such activity is so understandable in a successful business, management should make certain that an awareness of the participation in useful work is general throughout the business. Each employee and executive should understand that he has a useful job to do, and that each has his useful part to play.

Business not only gives people something useful to do and a better or worse social setting in which to do it, but business also provides people with a pattern of instruction and direction which gives order, sequence, and significance to the activities of the day. There are few in business who spend time in thinking up things to do. To be sure, there are a certain number in business who are

able to choose from among several things, all of which must be done, which one shall be done first. But for most people in business, the decision as to what shall be done and in what order, and the judgment as to whether what was done was well done, is made by others, not by themselves.

On the whole, and for most people, the direction provided by business in ordering their daily activities is helpful rather than hurtful. In doing well what has been assigned, there exists ample scope for the talents and energies of most people. The task assigned may be a small one or it may be large. It may be an instruction to a typist to type a manuscript or it may be one to a vice-president to organize a subsidiary. In any case, the direction and the purpose are imposed by the business, and the individual has the lesser task of doing well that which the business has given him to do.

There are those who rebel against this imposed direction and who prefer to decide for themselves what to do and when. Such persons, if their revolts are well-founded, are likely to rise fast and far or are likely to go into business for themselves. However, if their revolts are mere assertions of wounded ego, business is a bad place for them and they are bad for business.

The escape from decision-making, which business provides for most of those who work, results in the concentration of decisive power at the focus of the organization. Business does not eliminate from life the necessity for decision, but it does change the position of those who exercise decision by removing the power and responsibility from those for whom it is a burden.

Business also provides people a wide range of choice of the kind of life they want to lead. The choice narrows with advancing years. But the variety of talent needed in modern business gives rich opportunity for differences in taste and skill to find expression.

The variety of needed talents in business results in the opportunity for specialization for the individual. This means higher rewards for scarce talent, and for the community it means the development of latent talent and, as a result, the wider availability of useful things of better quality and at a lower price.

Under normal conditions, business can give great security and continuity of employment to those who are employed. The momentum of a going concern, even if it is a small business, carries the individual along with it. Experience teaches management how to even out production and how to supplement regular irregularities with a planned program of better use of plant and personnel. Management can do little in the presence of a general business depression, but even then it holds its basic organization together in the hope of better days ahead.

The contribution of business in giving people something to do is not without its darker features. How serious these conditions are should be judged by comparison with what otherwise might have been. Some may well feel that the negative elements so far outweigh the positive that the whole business system is thereby condemned.

First of all, on the negative side, the effect of business on the individual is to increase his dependence on a continuing need for his special talents. The ordinary simple ways of sustaining life he does not know. He can-

not find or grow food in nature, he cannot prepare it, he cannot clothe himself, nor can he construct his shelter—he frequently cannot learn another job. He is not only dependent on his specialization, but he is mentally dependent as well. The simple routine, free from responsible choice, has made him soft. Choice and decision have become fearful things. He does not know what to do unless business is prepared to tell him.

His interests have become narrow. The circle of his acquaintances is restricted and consists mostly of people in business like himself, some a little higher up and a few a little lower down in the business hierarchy—but all in his pattern. They have formed him and he has formed them, all within the easy limits of conventionality as the business—or its counterpart, the trade union—has ordained them.

The efficient routine of the business has created monotony and, with monotony, pessimism. The feeling of constructive production for human use is faint in the employee who realizes that the only thing he supplies to the machine is the wit to turn it off.

Business must understand these negative, darker aspects if it is to know precisely where it stands. True, the main task of business is to make things people want, but in doing so—concurrently and necessarily—it affects the lives of people as it issues its instructions and directions. Some of the consequences are beneficial, some are harmful. Prudence dictates the lessening of the harmful influences, even at the cost of some efficiency in the making of things which can be sold.

4. *A Place to Invest Savings*

The primary business of business is to get things ready for use, and we have already seen that in doing this business provides people with useful work to do. Business also provides a place for people to invest their savings as an incident to its primary job of making things to sell at a profit.

It is conceivable, and no doubt it sometimes happens, that a business is started primarily for the purpose of giving investors a chance to get an income on their capital. Usually, it is the other way around. The business, or the idea for a business, is developed and, in competition with other opportunities in which savings can be placed, it makes its case as best it can for the attention of the investing public.

Business is not the only place where savings can be invested. As we have said, there are farm mortgages and government bonds. But the business of making things has been of great importance in the savings it has put to work.

Like the instinct to do constructive work, the instinct to save goes deep into the roots of human nature. So deep is the desire to save that saving as such, purposeless accumulation, is a matter of common observation in both human and subhuman species. The squirrel goes on saving nuts, the boy collects cigar bands and postage

stamps, the miser hoards currency, diamonds, and gold, if he can get it—all in amounts beyond their reasonable needs. We know the rationalizations of the miser and the boy, the squirrel makes no effort to explain.

The instinct to save has a value in aiding survival in a universe of uncertain weather and certain misfortunes. Saving being an instinct, its exercise is accompanied by pleasurable feelings in the act itself. It does not have to be justified by its beneficial consequences, and it will continue in spite of efforts to discourage it.

Since we shall always have the instinct of saving with us, we should try to make the savings themselves as helpful as we can to the saver and to the community as a whole. The saving impulse is not sharply directed toward particular objects, and within limits it can be affected by conventions and public opinion.

One type, no doubt the earliest, is the saving of things which someday can be used. Such savings take the obvious forms of putting by food and wood when they are available in abundance. Sometimes, the savings are books to be read later, or linens, or silver which one day may adorn a home. The savings in things may take the form of labor applied to the building of fences, the draining of fields, or the care of livestock.

All these forms of saving of things themselves are exceedingly useful, and although there is no way of estimating the amount, it must be large. The development of the country, until recently, certainly, was based on savings of this kind.

But in the saving of things there is one limitation, namely, that what is saved now and what is available for

use later are the same. The things I am able to set aside and save today I may have no need for in the future. I want my savings in a form that will give me a claim in general on future products; on things and services yet to be made, or then existing, that correspond to my then existing requirements.

The form of saving that most clearly conforms to this desire for liquidity is money, coin or currency. But money has certain disadvantages as a medium of saving. It has disadvantages to the individual, because it may be lost or stolen, and it is wasteful, because idle money produces nothing. The hoarding of money also is harmful to the community in ordinary times because it interrupts the demand for goods and it reduces the level of employment. The saving of money in bank deposits avoids some of the objections which can be made to the hoarding of currency. Although we cannot be sure that the money so deposited will be put to work, there is a better chance of it than if the money had been hidden in a mattress or in a safe-deposit box.

The capital which business uses comes from the savings of the people. Sometimes it comes directly when stocks or bonds have been sold to individuals, sometimes indirectly when the securities of businesses have been sold to savings banks and insurance companies. Often the savings represent the undistributed earnings of the company, the property of the stockholders held back for the company's growth or protection.

The savings of the people after they have been put to work by business consist, for the most part, of tangible things: factories, machines, warehouses, ships, and inven-

tories of raw materials and finished goods. Some of the savings are intangibles, such as patents and processes, trademarks and copyrights, and that most intangible of intangibles, "going concern value" or goodwill. Out of the manipulation and transformation of these savings, the production and distribution of things for use takes place. The tangible and intangible things saved, under the direction of management and with the application of labor, help make available to the people far more than management and labor could have done working alone.

But although the true savings in business are the tangible and intangible aids to production, these savings are represented by securities, by stocks and bonds. These stocks and bonds are held by the people or they are held by the banks and insurance companies who have credited deposit balances to the people.

Through this process by which business provides a place and a medium for the investment of savings, (a) the savings of the people are put to work, (b) a share of the increased product can go to the people currently in the form of interest or dividends, and (c) the savings themselves can be turned into cash by the sale of the securities that represent them, when the time comes that ready cash is needed.

The opportunity provided by business for the investment of savings is accompanied by risk, not only the risk that the business itself may not prosper, but also the larger risks that will continue to exist in a world run by human beings. These risks have been recognized by the classification of securities according to priority of claim on capital and income. There is some feeling that all the

savings put into business should take the risks and share the benefits of the holder of common stock. However, as long as some people prefer greater safety and lower return to less safety and a higher return, business will no doubt continue to provide the form most satisfactory to the investor.

Many people believe that when they buy a bond or a share of stock on the stock exchange they are making an investment in business. Ordinarily this is not the case. All that is done when an investor buys an outstanding issue of a security is to turn the savings of some other investor into cash. This in itself is a useful thing to have done. It improves the general attitude toward savings in business, and in particular cases it may well be that the cash will be put into some new or expanding venture by the person who made the sale.

The purchase and sale of securities in the security markets does not directly put savings into business or take them out of business. But healthy security markets are an important part of business. Whenever the time comes that new capital can be used by a business, when the opportunity for the investment of savings arises, then the security markets perform their service of distribution, of bringing the place for investment to the attention of the people who have savings to invest.

5. Three Functions

This, then, may be said as to what business *does* and what it is *for* in our complicated modern world. First and primarily, it is the job of business to get things ready for use. Second, in doing this work of production and distribution, business concurrently provides people with productive activity—something useful to do—and a social setting in which to do it. Third, and finally, business makes a place where the inevitable savings of the people can be put to work.

These are great social tasks for any human institution. In doing the business of business it is the part of business to see that they are well-performed.

III

Business as Rule-maker

1. Private Government

WE have seen what business is for and what it does. How does it do these things? A business does these things by making rules, enforcing its rules when possible, and compromising them when necessary.

It is in no sense a figure of speech to refer to a company like the American Tobacco Company, and to each of its counterparts, large and small, as a private government. A business is a *government* because within the law it is authorized and organized to make rules for the conduct of its affairs. It is a *private* government because the rules it makes within the law are final and are not reviewable by any public body. Some might say that the reason a business is a private government is because it is owned by private individuals, but it seems to me that the element of private authority is more significant than the question of ownership.

It is important to note that this private government, the corporation or business, existing through the authority of public government, is in no sense an interloper.

On the contrary, it is the method we have chosen by which to get done, for the welfare of all of us, the work it is for private business to do. If conflict develops, the outcome is certain, since public government will necessarily in the end assert its will and private business will conform.

The reasons why private business has been given its freedoms, and its authorities, are partly historical, partly logical, and partly accidental. But the justification for continuing a similar role for business must be pragmatic. The grounds are simply stated: executive management, subjected to the test of profit margins under direct or indirect competitive conditions, has shown initiative, resourcefulness, efficiency, tenacity, and willingness to assume authority and to take responsibility. The returns of a material character have been vast in terms of the production of goods and services and in the organization of the resources of the world for human use.

But this executive management which has brought forth so much also has certain tendencies that, in a rule-maker, do not conform too well to our more basic notions of human values as expressed in our public democratic government. These tendencies and characteristics are in almost every case excesses in the very traits which are most desired in private executive management. Initiative becomes arrogance; resourcefulness, cunning; efficiency, greed; tenacity, obstinacy; and willingness to take authority and responsibility, pride and lust for power. This is a terrifying set of qualities to encourage in any rule-maker: arrogance, cunning, greed, obstinacy, pride, and lust for power. And yet they cannot be rooted

out without destroying the motives and energies which draw from private business its superb contribution to the public welfare. These traits, like any other powerful and dangerous force, must be stimulated, used, and held in check.

Therefore, it follows that in the relations of government and business government should take positive measures to encourage initiative and skill in business for profit; but, recognizing the dangers of excesses, it must provide measures for protecting the public against them.

A business carries on its operations through a multitude of decisions under its own rules. The rules made by a business to govern its operations must not be inconsistent with the law of national, state, and local governments from which it derives its authority and from which it receives protection. However, within the law, a business has great latitude in the rules it makes and in their enforcement.

Just as business as a whole is greater than the sum of its parts, so too the ramifications of business government go beyond a simple addition of the powers of each member of the business community. The individual companies which are associated in a group, such as the National Retail Dry Goods Association, have not only created a new rule-making body, an agency which is not a business but which is of business, but they have also increased their own individual powers and obligations. The interrelations of business are not confined to trade association membership, but cover a wide field, from open arrangements in purchasing and marketing to secret agreements on patents, processes, and pricing. The

system of private business government must be understood to include not only individual companies, but the relationships and mechanisms of relation between them as well.

2. One Among Many

The powers and responsibilities of business as private government seem relatively less formidable if we realize that business is only one private government among many private governments. These private governments all exist and function within the frame of public laws which have been adopted for their protection and regulation.

Three private governments in particular, other than business, affect profoundly the life of every individual. These three private governments are the family, the church, and the trade-union. At some points the rule-making of business is sharply limited by these other private rule-makers.

First, let us look at the family as one of these private governments. The rules of the family are not a written code. They are a set of practices and standards of value that are handed down with appropriate modifications by one generation to the next. They are not taught formally as a system of conduct, and it would be unusual if the senior authorities in a family group could easily recite more than a few of the compulsions that give this particular family its characteristic quality.

The rules imposed by a family on its members are of two general kinds: first, those which are common to most of the families of that nation, community, or neighborhood; the others are those which are more intimate to the individual family. In these are blended the personalities, the experiences, the successes and failures of the living senior generations and the traditions which they carry forward as their own.

The family rule-making protects the simple virtues, cleanliness, courtesy, thrift, and honesty; standards of workmanship and sportsmanship; standards of behavior toward persons of another sex, race, religion, or nationality. These ways of thinking and acting are imposed by the family authority.

To the extent that a family has acquired strong attitudes on these points of behavior, each member of the family is molded into conformity from his earliest days. The acceptable manner of conduct is displayed to him by example, right actions are encouraged, and deviations from proper behavior are punished by force, by ridicule, or by banishment.

As a result of early, long, and strict enforcement of the family rules, they become for the most part matters of habit. Conformity becomes the normal way of life. Deviations are punished, no longer by a senior authority, but by the uneasy discomfort of the individual's conscience.

The rules of the family depend not on regulation, but on habit and conscience for their enforcement. As the experiences of life multiply and as we come into contact with the codes and standards of other people,

changes take place in our own personal code. These changes bring our conduct into harmony with prevailing custom and with our own reasoned judgment as to what is useful and what is good.

The family as rule-maker stands before, beneath, and within all others. Its government is informal, flexible, but definite. If it finds itself in conflict with church, trade union, or business, the family will more than hold its own as a regulatory agency. When it is in harmony with other private governments, the family is a tower of strength in achieving authentic consent to a necessary frame of order and discipline.

A second agency of private government is the church. The rules of the family are supported by and, in turn, support the laws of conduct pronounced by the churches. Although much common ground is covered by home and church, there are wide differences of method and approach. Many little matters of great significance to the individual family are embraced by the church in the broad dictum of honor and obedience to father and mother. On the other hand, the family transmits certain basic rules, such as "Thou shalt not kill," "Thou shalt not steal," as the instrument of the church and with its sanction.

The laws of the churches are explicit, written codes. The words and meanings of these codes have been studied and debated for centuries. Differences in interpretation have caused the founding of different faiths, different sects of the same faith, different forms of the same sect—all to gain, within the narrowed circle of religious government, uniformity and precision in what

men generally take to be the most fundamental laws of all.

The sanctions for the enforcement of the laws of the church for the members of the church body are the most terrible and most unescapable. Conflicts between the laws of the church and those of other governments, public and private, are resolved in favor of the church for its own communicants. The churches admit no fallibility in the areas appropriate to their insight and they admit no compromise with the moral and spiritual law which it is their duty to reveal.

A third private rule-making agency is the labor union. Important as it is, compared with the family and the church it has much less authority and significance. But, in its influence on the working life of the individual, the labor union takes a full part among other governments with which business must be concerned.

The trade-union exists because of the unequal position of the worker under business rule-making. This inequality is particularly evident during a time of unemployment, when the scarcity of jobs has removed the individual worker's greatest source of strength, the threat in the ability to get another job with another employer. The union unites weak elements in a single bargaining agency, and collectively, under shrewd and aggressive leadership, the union is able to discuss the rules of employment with business managers on a basis more advantageous than the individual employee could possibly attain.

Trade-union rule-making has had a varied and mixed effect on the development of responsible individ-

uality of the individual trade-union member. Certainly trade-union organization today is chaotic; it constitutes a private rule-making agency of many paradoxes, held together by force and supported by legal sanctions. It has not been able to resolve its inner ideological and power conflicts. The individual member has little choice but to conform to rules to which he may not consent, and from which there is no escape. The trade-union has a big problem for the future in protecting in its own domain for its own members the constitutional rights and freedoms which our public government is dedicated to preserve.

Business, then, is one private government among many. We have mentioned the family, the church, and the trade-union, but there are others too, such as the organized social or fraternal club, which do a considerable amount of rule-making on their own account. All these operate in and about federal, state, and local public government, and all taken together provide a diverse and elaborate pluralism which shapes the conduct of the individual citizen.

Fortunately, the individual citizen is scarcely aware of the public and private pressures under which his choices are made. He sometimes refers impatiently to the Government, implying that the restraints to his liberty come from a single source. But the complicated pattern of public and private rule-making as it in fact exists requires that our freedom be achieved within a pluralism of authorities.

The special task of business is to do what it can to find its own place harmoniously in the pattern of con-

trols from which the order and certainty of a free society must be derived.

3. The Governed

If business is private government, who are the governed? We are the governed.

We are governed by business in one or all of four possible capacities: (1) as stockholder, (2) as vendor or supplier, (3) as customer, or (4) as employee.

Let us take these four capacities in which any of us may stand in relation to business and examine them. In what sense is the stockholder subject to the rule-making powers of the business in which he has placed his savings? One might have thought that it would have been the other way around, that the stockholders, being the owners, would have the rule-making power instead of being subjected to it.

The stockholders collectively elect a Board of Directors, and the Board of Directors elects a management. These elections ordinarily take place once a year. At the time of an election, the stockholders have the legal right to change the directors and hence to change the managers. They also have the right to vote on specific rules for the running of the business that may have been proposed in a Proxy Statement. But, except at the time and place of a stockholders' meeting, the stockholders ordinarily have no rule-making power. A large stockholder

may have large influence on the rules that the managers adopt. This influence may come as a result of the power he may exercise at a later meeting of stockholders, or it may be deference by the managers to a holder of property in the business. A small stockholder also may have large influence if his suggestions are helpful to the management. Access to management for the expression of ideas and criticism is frequently available to the smallest stockholder.

But the rules themselves are made by the managers, except for the few rules that may find their way into a stockholders' meeting. The rules of the business affecting the stockholder are far-reaching, and necessarily so. The amount to be paid out in dividends is determined by the Board of Directors. So also are borrowings that substantially affect the form of capitalization and the character of the stockholders' claims on assets and income. The directors may issue to the stockholders "rights" to subscribe to new stock. These rights give the stockholder the choice of providing additional capital or reducing his proportionate ownership in the company.

The freedom of the company in taking actions affecting the interests of stockholders is subject to legal limitations that experience has shown to be desirable, and the stockholder has access to the courts to enforce his legal rights. But the enforcement of legal rights is not the same thing as the power to make rules. It is only the power of protection against illegal rules.

The initiating power of the stockholders of a company as regards rule-making is limited in principle, and in practice it is even more restricted, due to inertia and

the sheer mechanical difficulties of getting stockholder action on any question. On the other hand, the authority of the Board of Directors in making rules affecting stockholders is direct, explicit, and decisive.

Under the private government of business, the stockholders are definitely among the governed, even though they may choose the Boards of Directors under whose authority the rules affecting them are made. Their position is something like that of the citizens of the state of Illinois (or any other), who vote for the senators and representatives who pass the laws which they in turn obey.

The laws regulating corporations are intended to give basic protections to the stockholders against business rule-makers, just as our constitutional rights are intended to protect us as citizens against the law-making and law-enforcing agencies of public bodies, federal, state, and local. In addition to the laws, the stockholder has a final safeguard against business rule-making that he may find uncongenial—he may sell his stock. True, he may not be able to sell his holdings for as much as he paid for them. And, if he wants an income on his savings, he may become a stockholder-citizen under another business government which may please him little better or no better at all. Nevertheless, he can free himself at a price if he wishes; he is not locked in. The company he keeps, he keeps by choice.

The second group among those governed under the rule-making of business are the vendors or suppliers of raw or semi-finished materials, manufactured articles for resale, or services of one kind or another, utilities, trans-

portation, and the like. The vendors are usually, but not always, other businesses which are making rules of their own for the business which is to them a customer.

The rules applying to vendors cover all the specifications made by the purchaser on the things that are purchased, the price that will be paid, when it will be paid, the quantities, qualities, and nature of the things supplied, the date of delivery, provisions for return of damaged or unwanted goods, restrictions on the sale to others, and all the rest. The contract or understanding in which these terms are embodied is like a treaty between two sovereign states. In entering into such a business treaty, both parties give up in some measure their freedom of subsequent action. They give it up because it is advantageous as compared with the alternative of making no arrangement at all.

Under ideal conditions, each business that is a party to a contract accedes willingly to the rules imposed by the other. Such conditions are met most fully when the vendor has some other independent company to whom he can sell his goods if he wishes, and when Company X has another independent source from which it can supply its needs. It is then possible to discuss terms in a spirit of give-and-take, and to reach a compromise which, at the moment of decision at any event, seemed the best choice among real alternative possibilities.

Such equal conditions are not uncommon in the relations of one business to another. Yet inequality of bargaining power will always exist; when it is too great, imposed terms may be the result. The use of force is just as ugly in establishing the rules of a business contract as

it is anywhere else. The coerced contract is of course resented in business, but it is not considered a wrong business practice. Many businessmen, large and small, welcome situations in which they are on the upper side of a business squeeze, and their resentment when they are on the lower side is not taken too seriously by their colleagues who happen to be spectators for the moment.

As a matter of fact, one test of survival efficiency in business consists in not being subjected to coercion too frequently or too severely at any one time. The last coerced act on a business is the step just next to bankruptcy. The inefficient or unwanted business cannot be protected from rule by force, because its own nature determines that it shall be weak when another is strong.

But if any one business becomes too strong, and too many of its vendors become too weak, let the buyer beware, not of the quality of the goods he buys, but lest he turn up some morning legislated a public utility. Or perhaps the weak, having a common cause, may legislate themselves into equal or superior strength. Private business governments are not averse to using the powers of public government if they can seize them to ensure their survival or even to reach what they conceive to be an appropriate place in the business sun.

The third group of the governed are the customers. The businesses which are customers of other businesses we have dealt with in our consideration of vendors. Most customers, the tens of millions of them, are individuals buying things and services at retail.

Superficially, the individual customer seems to be at a great disadvantage in being subjected to the decisions

of business management as to what he shall be offered, where and when he can get it, and how much he will have to pay for it. The business management can make its rules and back them up with administrative organization, physical plant and equipment, money in the bank, and propaganda.

But the inequality is not so great as it appears—in fact, the strength may be with David Consumer if he does not have to buy, or can postpone his buying, or can find something else that will do, or some other place to get it. Then the imposing property and organization and resources of the Goliath Corporation become clumsy handicaps before David's power of choice. The company and its rule-making managers find themselves faced with a debilitating condition called "idle plant expense." Idle plant expense will slowly but surely force the business rule-makers to modify their rules to meet the views of the governed.

Does this mean that the customers make the rules? Not at all. It only means that when the customers have the power of choice, the rules that are made will be acceptable to them. Business management will still decide what will be offered and when and where and for how much. Neither individually nor collectively do customers have the ability to make rules or to enforce them. But collectively the customers determine what rules shall in the end survive.

The customer requires the aid of public government in order to make his power of choice worth anything to him. This aid takes the form of giving him the information he needs as to what is available and at what price.

Sometimes public market places are provided so that a wider choice exists than otherwise would be the case. Laws covering labeling, misbranding, and the like are all measures that strengthen the effectiveness of customer choice.

When there is no choice to the customer, when a single company is the only source of supply, as is true of telephone service or electricity or sometimes transportation, the customer is helpless if the product or service is indispensable for health and comfort. In these cases of natural or artificial monopoly, the more important rules of the company affecting the customer are regulated by public government.

The fourth group of people governed by private business are the employees, all of them. The president of the company, the vice-presidents, the deputies and assistants, the superintendents and managers, foremen, bosses, and workers—male and female, part-time and full-time, employed or unemployed—all are governed by the rule-making of private business. Some of these governed are themselves subordinate rule-makers, promulgating codes and issuing instructions with the authority of the business-state by which they are employed.

For most people, the rules that most intimately affect their lives are made by their employers. Most of the employed and of those who wish to be employed, but are not, look to private business for employment. The rules affecting employment made by private business are therefore of paramount importance to the individual.

These rules determine for the individual where he shall work, when he shall work, what he shall do, who

will give him orders, who will take orders from him, his promotion and discipline, the amount he gets paid, and the time and duration of his holidays and vacations. These rules are not general conditions and circumstances of work which, we have already observed, affect the individual's health, outlook, and character. These rules are specific determinations by a superior and authorized agency of what and how things shall be done. The governed are governed by these determinations.

The employees, all of them, are weak as compared with the company that makes the rules and enforces them. To compensate for this weakness, we must look to three offsetting balances. The first is the labor laws of public government, the second is the trade-union or other private organization of employees, and the third is the chance of getting a job working for some other company or of getting by without doing any work at all.

The labor laws of public government set up a framework in which business government must confine its own regulations and decisions. These public laws express standards of health and decency which the community considers basic to the kind of life it wants for its every member. The enforcement of the laws reflects the sincerity and skill of the community in translating its aspirations into reality. Good labor laws and sound enforcement put a floor under competitive reduction of working standards as a means of reducing costs. Unquestionably, they make a certain number of people unemployable, since at the standard imposed by law it is not profitable to employ large numbers of the unemployed.

The fact of trade-union organization, and sometimes

the threat of it, affects business rule-making generally in a manner favorable to the employees. Like the labor laws, the fact of unions establishes minimum conditions for various classifications of employment. Also like the labor laws, they make certain people unemployable. The unions also strengthen the position of the individual employee in cases where flagrant injustice may be done in the decisions of an administrative officer.

But neither labor laws nor trade-unions can do more than give the broad framework of conditions of employment and occasional protection to the individual in extreme cases of maladministration. Just as the true strength of the customer in the apparently unequal negotiation with the business company was found in the ability of the customer to go elsewhere to do his business, so too the strength of the employee lies in his ability, when he has it, to get another job from another employer or to get along without doing any work. The laws and the unions may help provide a basic setting for private business rule-making, but they can never do enough to give to the employee a real feeling that in conforming to the rules affecting him he has exercised responsible free choice. Even for the executive, the ability to get a job elsewhere and the courage to do it are the only conditions under which subjection to business rule-making is supportable by free men. It is obvious that under the large-scale unemployment of the 1930's, the reality of freedom, guaranteed politically under the Constitution, was actually lost under the economic exigencies of the period. It was lost, not because business set out to destroy it, but because where there is no choice of rule-makers, as under

mass unemployment, no rule however beneficent can be accepted by the individual as a matter of responsible consent. The economic system as a whole coerces him even though the particular employing company does not intend to do so.

Thus we see that tolerable freedom of the governed under the private rule-making of business, of the stockholders, of the vendors, of the customers, and of the employees of all rank comes from the opportunity to say, "No! I will do my business with another business." When the governed can say "No" they have powers as great as those of the strongest business.

IV

The Structure of a Business

1. What Is It?

A BUSINESS gets done the things that business exists to do by means of rule-making activities which are both necessary and desirable. Because of them, business is private government in more than name only. Now we should like to know, what kind of government is this? How does it work? To answer these questions, we must find the places in a business where rule-making power exists, and then find out where that power came from and how it is controlled. Let us look at the structure of a business and see how it is put together on the inside.

Companies differ in the way they are run. New companies, closely held companies, subsidiary companies, small companies, and the large publicly owned companies show much variety in the way that control is administered. The large publicly owned company is easier to understand because the specialized aspects of control can be seen at specialized points, instead of being merged. After studying this separation of powers in the large publicly held company, we can refer to the less elabo-

rately organized businesses and make due allowance for the fact that several functions are being carried on together. The small, individually owned corporation, such as a personally owned and operated store or construction company, will merge, in a single individual, powers of stockholders, Board of Directors, chairman and president. For practical purposes, this owner-manager rarely needs to ask himself which robes of authority he is wearing when he takes any particular action.

To find out realistically how things happen, let us, the governed, approach a business from the outside and work our way in. We can come at the business either as an employee, a vendor, a customer, or a stockholder. From whatever point we come, we run into an employee whose job it is to attend to us. If we are looking for work, we see an employee of the employment department; if we call to discuss the job we have now, we talk to the executive to whom we are responsible. If we are a vendor with something we want to sell to the company, our first contact is with a representative of the purchasing agent, or with the buying office. If we are a customer and wish to buy something for ourselves, or if we wish to discuss something we have already bought, we meet a salesman or an adjuster. If we are a stockholder, we first talk to an assistant treasurer, or an assistant secretary, or an assistant to the president. In every case, we find that The Company is represented by a subordinate Someone who has authority to make certain decisions. In every case, the Someone who represents the Company gets his authority from a superior Source in the company's management, a Source which combines legislative, administrative, and

judicial powers. This superior executive may be overruled by an executive superior to him unless he himself happens to be the chief executive. From whatever angle we approach a business, as we rise higher and higher through the levels of authority, we finally come to a chief executive who is usually the President of the Company.

In most things in a business the president is the boss. Working through his subordinates, he gets done the things that have to be done. In many cases he also decides on the policies that will have to be followed in doing them. He can buy and sell, hire and fire, construct or tear down. Among the few things he cannot do by himself are to declare a dividend, open a bank account for the company, sell its securities to the public, or dissolve the business. One other thing he cannot do as president is to appoint himself to his own job.

Sometimes a company has an officer who is called Chairman of the Board. The powers and duties of a chairman do not follow a consistent pattern. In general, the powers over policy that are reserved from the president, and are not reserved to the Board of Directors, are exercised by the chairman. The chairman has particular supervisory responsibilities including observation of the work of the president. It is doubtful if the chairman would give instructions to the president as to how he should operate the company even if he had the power to do so. If he did give such instructions, he would then himself be the chief administrative officer under another name, and the president would then be his assistant.

The titles of the officers holding top company authority are by no means uniform in business, and are

unimportant for this discussion. What is important is to realize that there are two related, separable, top functions: (1) that of long-time policy planning with broad consideration of the company's relations to trends within the industry, in other industries, in the government, and in international affairs, and (2) that of day-to-day central co-ordination of operating decisions covering every phase of doing efficiently the things that it is the business of the company to do. Sometimes the name "President" is given to the officer who does the first; sometimes "Executive Vice-President" or "Operating Vice-President" or "General Manager" to the second; sometimes the two are carried on together by an officer named "Chairman" or "President."

The powers that are withheld from the president and chairman, or chief executive officer under whatever title, are held by the Board of Directors. The Board of Directors elects the president, elects the chairman, and other general officers, fixes their pay, and decides all questions of policy which it does not choose to delegate to either chairman or president. The Board of Directors also will approve large acquisitions and transfers of property, although usually the chief executive has the power to complete these transactions if they are urgent or if he wishes to do so. The Board of Directors declares the dividends that are paid to stockholders, approves the terms of any borrowing other than for temporary purposes, and decides if, when, and how to issue any unissued stock.

Where does the Board of Directors get its powers? They come from the laws of the state in which the com-

pany gets its charter to do business. These laws specify what things the Board of Directors may do and what things are reserved even from them to the stockholders. And of course, under the laws of the state, there are other limitations on the powers of directors. They must carry out the contracts the company enters into, and they cannot override laws having to do with the regulation of business, the conditions of employment, and the like.

The stockholders ordinarily have no powers except at a stockholders' meeting. Regular meetings are infrequent and special meetings are hard to call without the consent of the directors. So, for practically all purposes, the Board of Directors is supreme.

This description of where the power in a company is located is reasonably realistic—with one exception, and here the situation differs greatly from company to company. The president or chairman of a company generally recommends to the Board of Directors what he thinks the Board should do even in the field of the Board's own powers. In some companies, such a recommendation is tantamount to a decision, and although the recommendation may be discussed and the president may change his mind, the directors never reverse him. A reversal would be taken as a vote of no confidence, and his resignation would be on the table forthwith. In other companies the executive officer encourages the Board of Directors to come to its own decision on the matters that are its proper concern, for example, on the declaration of a dividend. The officer may advise the Board what he, as an individual, would do, but he has no feeling of

chagrin or embarrassment if the Board, after talking it over, feels differently.

The Directors of a company are persons of considerable importance in rule-making powers of a business. Consequently, it is a matter of some interest how the members of a Board of Directors are chosen and how they are continued in office. At this point the form and the substance of the location of power in business are far apart.

The form for the election of directors is familiar—the directors are elected for fixed periods or until their successors are elected by the stockholders, each stockholder having voting strength in proportion to his share in the aggregate voting stock of the company. When a director's term of office expires, he is re-elected or his successor is chosen on the same basis.

The form of election of directors is a quasi-democratic procedure for the affirmation of the delegation of power to candidates for election and re-election. The procedure accepts on principle the assumption that the final power over business rule-making resides in the owners of the property, and that the larger the relative ownership the larger the right to express preference for the individuals to whom delegated powers should be assigned.

Without raising questions as to these assumptions, it is fair to note that in substance the selection of directors does not conform to the intention that the election procedure implies.

The fact is that the stockholders *elect* the directors but they do not *choose* them. They are *chosen* by the

Board of Directors itself, which makes the nominations.

The reason for this lack of correspondence of form and substance rests on two practical considerations: (1) The stockholders cannot choose directors because they are not organized as a political body in a way to make their franchise effective. (2) Real choice of directors by stockholders would be an extremely costly and disruptive procedure, damaging to efficient management, to business profits, and to the interests of the stockholders themselves.

The stockholders have invested their savings in a business to make profits and income, not to assert rights in the delegation of power. They do not want to be organized politically as stockholders; they want to be let alone. In this the management agrees with them. The occasional crisis situation can be ignored, since the political organization of stockholders to oust a management is generally so crude as a technique of obtaining stockholder consensus that it is a travesty on the "democratic" procedure it purports to be.

What name shall we give to this private government of business? Certainly it is neither a democracy nor a dictatorship. If it is an oligarchy, the oligarchs must stand for election, since they do not rule by right of status. The governed may escape from any particular business rule; they are not bound to any particular business rule-makers. No traditional name applied to governmental forms seems to fit the business pattern with its peculiar amorphous quality. Perhaps the best name of all for business government is "business," if we understand

and remember that business is government, that it is rule-making, and that it is not a depersonalized, mechanical, and materialistic economic activity.

2. *Directors and Officers*

We have not been able to put our finger on the exact point of final power in a company, but we have narrowed its location down to the Board of Directors and the two principal officers, the chairman and the president. Under extraordinary circumstances, power can be exercised by the stockholders, but this is difficult and rarely happens. The directors are elected by the stockholders, but as we have said, they are not chosen by the stockholders, since the stockholders are not organized to nominate candidates or to inform themselves on the merits of individuals or of issues. Not only is the residual power of a company which legally belongs to the stockholders not exercised by them, but it would cause indescribable confusion if they attempted to do so.

As a matter of fact, the interests of the stockholders as property owners entitled to efficient management and to a proportionate share of the profits, are reasonably well-protected in the case of most companies. They are protected, since in most cases one or more of the larger stockholding groups are represented on the directing Board. Through them, all stockholders, large and small, may be present at the seat of authority. In practice, this

representation is adequate although it may be inefficient and ineffective. Occasionally there is a conflict when the personal interests of large stockholders differ from those of small, or when the interest of the large stockholders is greater in their role as managers than it is in their rights as owners. When such conflicts of interest occur, anything may happen; it is impossible to generalize. Sometimes, even when there is conflict of interest, the larger investors assume the responsibility of trusteeship for *all* stockholding interests; sometimes they do not.

Within the circle of directors and principal officers, the locus of power differs in different companies and in the same company from time to time. Sometimes it changes even in the same meeting on different issues. If the chairman or president is an extremely strong or self-willed individual, he holds the reins in a firm hand. He may use the members of his Board of Directors as a sounding board, as a source of advice, as a means of access to influence in quarters outside his own company. But the most dominating governor is likely to pause if three or more directors differ audibly with his decision. The next time it may be three other directors who differ, and the time after that another three. Minorities are helpless alone, but several minorities may mean a revolt. Whenever ownership and management are held by different people, it can never be said that the Board of Directors does not matter.

The locus of power may, for a moment or on a particular issue, be held by a single director. Generally this occurs when a strong will holds a negative opinion. It is rare that a single individual on a Board of Directors

can get positive action taken contrary to the wishes of the officers.

Sometimes a single director is able to have his way time after time as a matter of practice. When this happens the situation in the company is definitely pathological. Either the chairman is weak or timid in policy leadership or the president is weak or unimaginative in administration. Here the director has stepped out of his proper place as director and has assumed powers that, for the good of the company, should be continuously exercised by the officers.

The decisions that must be made by a company require that a final source of authority be instantly available. Accordingly, an Executive Committee, with power to act for the Board of Directors between meetings is set up; and in this committee, the details of questions of policy and operations are examined. Many decisions are made by the Executive Committee that need only be referred to the Board for information and ratification. Included in the membership of the Executive Committee, there will be one or more of the executive officers of the company.

Because of its frequent meetings and knowledge of what is going on, the Executive Committee of a company comes to have great power. Frequently, in smaller Boards, the Executive Committee will include a voting majority of the Board, and so, in a formal sense, the Board is powerless against a unanimous Executive Committee.

The power element in a company is more nearly an area than a point, a pattern within the Executive Com-

mittee. It shifts within the boundaries of the Board of Directors, the Executive Committee, and senior officers. Sometimes the focus is sharp, sometimes it is blurred. It may include one combination of personalities at one time, another at another. Power in a company, within this area, seems to go to him who wants it and is able to exercise it. For the effectiveness of the company in doing the things that a company is supposed to do, this shifting character of the locus of power is desirable. It keeps an administration from becoming too brittle. It creates a narrow circle where there is a normal and healthy competition for internal status and recognition. Carried too far, such competition can be destructive to united efforts, but ordinarily the influence of the Board as a whole moderates the intensity of personal ambitions and divisive tendencies. When the Board itself divides, and continues a division over a period of time, again a pathological condition exists that is harmful to the business.

We have already seen how directors are elected, but we must carry our questioning a point farther. How does a particular person happen to be a member of a Board of Directors? In the first instance, as we know, the directors are chosen by the owners who start the company. If the owners have already decided who is to be the first chief executive, he will usually be one of the directors, and will be consulted about the rest. In order to expedite decisions, one or more officers in addition to the chief executive will be placed on the Board of Directors.

The directors who are not operating officers may be classified as either stockholder-representatives or "others." The stockholder interests may be a single in-

terest, but usually several recognizable ownership interests sit at the table. "Others" includes many kinds of directors, frequently legal counsel, sometimes financial and engineering counsel, occasionally public relations or political counsel. Not infrequently a director will be chosen who acts to tie together the interests of one company with those of another. Often one director will serve several companies in such an "interlocking" capacity. And, of course, there are other miscellaneous reasons of a personal or prudential character why particular people are asked to serve on particular Boards.

The effect of the manner of nominating directors is to perpetuate the type of company control and to strengthen the elements of power in a company that are already dominant. This makes for continuity of policy and administration. It also makes for inertia and narrowness in point of view and experience.

Why are men willing to accept directorships? These positions require time and attention, they are subject to serious risks of suit and scandal, to the reporting of personal ownership of stock and of changes in stock ownership. Occasionally, they involve exceedingly embarrassing personal conflicts and relationships with other people.

If a man accepts the risks and burdens of a directorship of a company, there must be reasons which to him are good and sufficient. In this, as in other things, the result must have a cause sufficient to produce the effect.

First of all, the officers of a company accept places on their Board of Directors for obvious reasons. They want to participate on an equal basis in making the general rules which they must administer and interpret. They

want to be present and to express their views as a matter of right when the rules are made and they want access as a matter of right to the formal meetings and to the records of the Board. The officers have both a personal interest and a management interest in Board membership.

The stockholders who have a large investment in a company also have an obvious desire to be represented on the directing Board. It is their property that is being managed, and they not only want close and frequent contact with the management, but they want to have something to say about the rules under which the business is carried on. The principal stockholders may join a Board of Directors personally or they may be represented by a deputy or agent. In either case, the interests and the motives of the director are clear.

The members of a Board who are elected because of a technical or professional competence, lawyers, engineers, public relations specialists and the like, are usually present because they or their firms are on retainer from the company. Service on the Board of Directors is part of the work for which they are being paid.

As we pass beyond these three classes of directors—officers, owners, and consultants—the motives become less clear and they are frequently mixed. One set of motives may be called "personal," that is, the director finds in his directorship a satisfaction of some personal wish which to him is important. These motives may be largely unselfish, as, for example, a desire to accede to the wishes of a friend who may be an officer or another director. Or it may be a real sense of public responsibility as an invitation to serve as a director of an insurance company, a

savings bank, or a great industrial empire. The narrower personal motives we are all aware of—vanity, sociability, occupation as an antidote to idleness and boredom, or a gossip's curiosity as to what is being discussed on the inside. Some men accept directorships because they wish to participate in the active business life of their nation or community.

A few men may serve for the nominal director's fee which is part of the ritual of a Board of Directors meeting. Even if service on a Board is not given because of the fee, it is generally believed that better attendance at meetings is the consequence of giving one. When directors' fees were paid in gold coin, they made a pretty souvenir of the meeting. Now directors' fees are paid in paper or by check and are subject to income tax in the director's highest bracket; and if they are in fact an inducement for the Board membership, they probably result in keeping the wrong kind of men on the Board. There is no denying that even the right kind of men, serving on Boards of Directors for other good reasons, get pleasure out of the director's fee which is for them a little extra cash.

There are few men who are directors of a sufficient number of companies so that the directors' fees in the aggregate become a significant part of their income.

Another group of directors are those who are there to serve some interest external to the company. These directors are not necessarily parasitic on the company, but they are likely to be so. In exchange for their contribution as a director, they expect from the operating officers of the company special consideration for their

bank, insurance company, coal mine, railroad, or other primary interests of their own. Not always, but frequently, this special consideration can be given only at the expense of what the judgment of the officers would otherwise cause them to do. In this way special interest representation is parasitic, thriving by eliminating competitive pressures and at a cost to the company.

Special interest representation on a Board need never be parasitic, if officers and Board resist it. Special interests may be represented by men whose personal talents are desired for the company. The only adequate payment that can be made to such a director to secure his services is the willingness of the company to use the director's own service and product, but there is no reason why this service or product should not be supplied at or below prevailing market and still be advantageous for the director-supplier.

Considering the central position of the Board of Directors as an institution, not only in the government of a single business, but in the government of business generally, it is in its present form an inadequate instrument of power. It is a vestigial remain of a time when investors paid attention to their businesses and when offensive and defensive alliances in business were the order of the day. The most that can be said for the Board of Directors as it exists today is that it provides an arena in which the ablest, most powerful, and most persistent members of the Board can generally have their way. Such men have the traits that make businesses successful, and their survival in the shifting locus of power in a company means that they survive not only for their

own good but for the good of the company too. The Board of Directors tends to screen the fit from the unfit, and to that extent to provide the rule of the fit for the conduct of the business.

3. Transformation

Need anything be done? If the Board of Directors is a vestigial and obsolete institution, sooner or later it will disappear in its present form. This disappearance may come by transformation or it may come by collapse. Collapse is a clumsy and uncertain way of moving from yesterday into tomorrow. Transformation gives an opportunity to consider the question of what is wanted and to choose a preferred method of getting from here to there.

What is it that we want in a Board of Directors? First, we want a rule-making body superior to the executive officers that will contribute to the efficiency of the business. Second, we want a rule-making body that is sensitive to the interests of all who are affected by the company as a private government.

When we examine these interests, a curious fact appears. The interests of the four parties are in part identical in that each of them benefits by an efficient, well-managed, growing business. For the stockholders this means the possibility of larger dividends and a higher market price for their stock. For the vendors it means a better outlet and prompt payment for the things they

supply. For the customer it means better service, better quality, and a wider range of products from which to choose. For the employee it means steadier employment, higher pay, and better conditions of work.

But at any given level of activity and efficiency of a business, the interests of the four groups of the governed are in conflict. At a given level of activity, higher dividends can come only from lower prices to vendors, higher prices to customers, or lower labor costs. Vendors can get better consideration only at the expense of stockholders, customers, or employees. Customers must pay higher prices if the desires of stockholders, vendors, and employees are to be met, and the employees can improve their earnings only at the expense of the other three parties at interest. A Board of Directors, therefore, has a double task, first, to provide the company with an efficient, aggressive management, and second, to make sure that at any given level of activity and efficiency, the groups at interest whose interests are necessarily in conflict get a fair deal.

There have been two suggestions as to how the several parties at interest in the operations of a company might be effectively heard. One suggestion is that each of these groups should be represented by directors of their own choosing. The other is that there should be a "public" director on the Directing Board, an appointee of the Securities and Exchange Commission or of some other public agency. Neither suggestion meets the requirements of the situation in more than a formal way, and both should be rejected as unrealistic and undesirable.

The idea of representation of parties at interest other than stockholders appeals to those who are attracted by the machinery of republican democracy, and who would extend it to all fields where discipline and order make it necessary to have rule-makers and rulers. The fact is that no group can be represented by an elected agent unless it has been organized to express itself politically. It must have a sense of common interest and a willingness to take the trouble at an appointed time and place to assert the privileges of an electorate. There must be understanding, not only of issues, but of the capacity of the person who stands for election. Sound choice requires elaborate procedural arrangements, opportunities for discussion and information, candidates, nominations, and campaigns. The necessary conditions cannot be established in practice for stockholders; nor can they be established for employees if we include employees of every rank and skill; nor can they be made to function for customers or vendors. A scheme of representation of these interests would be a travesty on democratic procedures. It would result in business political gangsterism that would destroy the efficiency of business management. It would inject, into circles requiring the most intimate confidence, individuals whose reliability was uncertain and whose motives and ambitions would be in doubt. A Board elected in such a manner would be injurious to the true welfare of the four groups who have an interest in the success of the business.

The second idea, that of "public" directors, appointed by some designated public agency, appeals to some who distinguish only two parties at interest in a

business: one, the owners; the other, the general public. But in reality there are four parties at interest, not two. In some matters these four interests are the same and in other matters they are in conflict. No "public" representation on a Directing Board could meet the essential requirements of this rule-making situation. The special and specific interests of a company's stockholders, its vendors, its customers, and its employees justify the creation of an opportunity for expression, but it is they, not an undifferentiated public, that should be heard by the company's rule-making authority.

In so far as there is a true general public interest in the company's management, it is expressed in the laws of the state, of the city, and of the nation. Conformity to these laws is the public obligation of the business and the administration and enforcement of these laws is the responsibility of public bodies, including the courts and the legal profession as an instrumentality of the court.

If we reject these two suggestions for broadening the composition of a corporate Board of Directors, what suggestion can be proposed? No drastic nor universally applied scheme of altering the composition of Boards of Directors should be contemplated. The situations in different companies call for different measures, or perhaps in some companies for none at all. Further, in modifying an agency like a Board of Directors, it is a good thing to take a step at a time, to let adjustment and habit build familiarity with the new, and then move forward with knowledge and conviction that the direction is the right one.

Accordingly, my suggestion is this: as a first step,

one director be elected or re-elected and he be asked to act as "trustee" for one of the three parties at interest, other than the stockholders. Such a director-trustee might be assigned the interests of either the customers, or the vendors, or the employees, depending on the nature of the company's business. He would be the nominee of the management and of the existing Board of Directors and would be elected in the usual way by the owners of the company, the stockholders. During the experimental period of whatever length, no public announcement would need to be made that such a policy had been adopted.

In a formal sense little is changed, but an important difference would occur in the deliberations of the Board. Let us suppose that this first director-trustee has been asked to act for the customers of the company. Although he owes his nomination to his fellow directors, and his election to the stockholders, nevertheless he has accepted a trusteeship—a trusteeship which has been created voluntarily by those choosing him so to act as trustee. Now as he sits on the Board, the interests of the customers of the company are his single interest. It is his duty to know what these interests are and to see to it that they are considered when matters affecting them are decided upon. Such a director-trustee should be chosen for his ability to make another's case his own. The one limitation that should be observed is that there should be no conflict of interest in the individual director himself, for example, a stockholder should not be chosen as trustee for the interests of customers.

The director-trustee should have time to work on

his job and to think about it. His duties would not require his full time, but they would involve more application of effort than does the conventional directorship. Such a director should be properly compensated for the service he performs.

If the first director-trustee works out usefully, the next step would be a director-trustee for each of the other interests—all depending on the nature of the company and whether the groups are important enough in the particular case to warrant specialized consideration. In this way, three of the four parties at interest will have someone designated to speak for them. Presumably the stockholders, the fourth party, will be the concern of the remaining directors. But to make sure that equally thoughtful attention will be given to all the stockholders, one director should be explicitly charged with responsibility for *all* ownership interests and be paid for taking the time required in doing so.

The Board of Directors would then consist of four paid director-trustees, the chairman and the president, and such other officers and Directors as the needs and traditions of the company dictated. Under such a Directing Board, the interests of the governed will be at least represented and the actions of the company's administrative officers will take place in a frame of reference where the interests of all will have been heard.

The scale payment of the director-trustee is an important point of detail. The money paid for the service should be sufficient to be a real incentive for serving. We should eliminate any necessity to appeal to motives of

public service, vanity, or any external, irrelevant interests.

What should a director-trustee be paid? There will be a wide range according to the size of the company and to the time, attention, and talent required. A rough approximation can be reached by making certain assumptions as to how much work a man could do as a director-trustee of several companies if he spent all of his time on these appointments. About the most a man could do and do well would be to serve as a director and member of the Executive Committee of three companies, and a member of the Board of four more. If we assume that to be a member of an Executive Committee is twice the job of being only a director, we have a full-time responsibility ten units of time, six for Executive Committees and four for simple Board membership. On this basis, a man should be paid one-tenth of his full-time earning power for a simple directorship and one-fifth, or twice as much for membership on an Executive Committee.

The essential point is that the director-trustee should be paid for his time at a rate that will give the company the service it must have if it is to do more than mere shadow boxing in extending the area of consent in the rule-making of private business.

The question will arise, need anything be done at all? Granted that the customers, the vendors, and the employees do have an *interest* in the kind of business rules to which they are asked to conform, they have no present *rights* in the matter. The stockholders have the rights; if they do not choose to exercise them, that is their right as well. Meanwhile, the business goes on, meeting on

every side the test of competition, and preserving its authority as long as the governed consent to the rules that are imposed. A policy of doing nothing usually seems to be the prudent policy at any particular time for any particular group of people. Yet, after something has gone wrong, in retrospect it is possible to see that adjustment to the times and circumstances would have preserved a continuity of experience and tradition which, though modified, would not have been dissipated.

In considering whether business should do anything to give a voice to interests other than those who have rights to express themselves, we must remember that each business derives its power and its form from public government in which all these "interests" do have "rights." If these interests someday want new rights in the government of business, they can be acquired through orderly public legislative processes.

Today the obvious interests of the several parties subject to business government are not properly safeguarded under the present form of control of business power. Since they are not, someone will someday, perhaps at a most inconvenient time, make it his crusade to turn these interests into rights. If, before this happens, the interests of all parties are protected by business itself, it is unlikely that formal intervention would occur on grounds of abstract political theory.

Quite apart from reasons of prudence and justice, an arrangement that would effectively present in the meetings of directors at the moment of decision the interests of vendors, customers, and employees, would improve the operations of the business. Bringing these

points of view authoritatively into the Board meeting would make certain that they are fully expressed and that they would not be brushed aside. Take, as an example, the most important decision that the Board of Directors has to make, the choice of a new president. The candidates under consideration for that office will be evaluated by a small Committee of the Board on their likely ability in managing the affairs of the company. The directors will collect evidence as to ability, energy, integrity, and experience. Information as to the sensitivity of the several candidates to management relations with employees, vendors, and customers will be considered in a general way. But it would be far better if in this company there were directors who had made themselves informed on these matters and who could contribute judgment of more than a casual kind to the whole Board of Directors when it makes its final choice.

A Board of Directors should represent a balance of "inside," or officer, directors and "outside," nonofficial, directors. If a Board consists of too large a proportion of officers, it loses its supervisory quality and the members become self-protective in deferring to the wishes and explanations of their colleagues. On the other hand, if a Board is composed too largely of outsiders, outside interests tend to distract from the attainment of corporate unity, and the absence of strong, informed, and frequently diverse officer opinion limits the insight of the Board as a whole into the more complex problems facing the company.

A troublesome problem arises when a director turns out to be unsuited for his responsibilities. His fel-

low directors hesitate to ask for his resignation unless the situation is really acute, and flagrant unsuitability rarely occurs. The result is that Boards of Directors are frequently cluttered up with members who are "feebly good" and who continue in their post only because no one wants to take on the awkward job of speaking a few homely truths. The harm that is done is both affirmative and negative, and the responsibility for a sound Board of Directors is one which the chairman cannot properly evade. The cleansing of a Board will be much easier if directors are fully compensated for their responsibilities. It is easier to terminate paid services than it is to bring an end to honorific appointments. If directors who themselves know that they are not pulling a full oar would resign without waiting to be asked, they would spare their colleagues much embarrassment.

The reasons for taking steps to modernize the Boards of Directors of companies are reasons of efficiency, prudence, and justice. Fortunately, there is no critical situation that presses for action, but unfortunately there is, under such circumstances, an understandable hesitancy about altering existing and known power relationships. However, the mere passing of time brings with it the necessity for change in the personnel of a Board of Directors. These occasions, if used to a purpose, may lead to the transformation of the central agency of corporate power so that it represents more nearly the interests of those whom business governs.

V

Profits and Compensation

1. Energizers

THE locus of supreme power in a company lies within the circle of the Board of Directors, including the two principal officers, the Chairman and the President. From this source come the rules, the instructions, and the delegation of specific responsibility, the provision of means and the outlines of ways. Here is found the co-ordination of the parts and of partial efforts. Within this circle, the character of the company takes form. Into this circle come experience, inspiration, and criticism from the organization as a whole, and from this circle flow judgments which give back to the organization direction and discipline.

But, although we have located the seat of power and have learned how the power is applied, we still lack an essential bit of knowledge for our understanding of the working of business. We still need to know why the power is applied at all, what energizes the business machine. What is the impulse to action?

By all odds the most important energizer of cor-

porate power is profit, the experience of profit, and the prospect of profit.

Profit is not the only motive which brings corporate power into action. Corporate power is released and directed by all the forces that cause men to act: loyalty, vanity, restlessness, love of achievement, and the tendency of motion to perpetuate itself in habit. Within the circle of authority in a business, these personal drives become of great significance in understanding the reasons for any particular decision. But, so far as corporate power is concerned, they are ordinarily secondary, since, although they are motives to the individual, they may or may not be relevant to the business of business. The underlying and unifying force, releasing all others and giving meaning to all else, is profit. It is not merely the spark plug, it is the spark within the plug.

Our point of view toward profit is strictly pragmatic. We are interested in how it works, whether it works well, whether it could be made to work better. We are interested in the efficiency of profits as a directive energizer.

The compensations of the principal officers of a company also are energizers. Over a period they determine the kind of people in whose hands power of a business shall be held. They usually determine in whose particular hands particular authority is exercised. The officers' compensation is both payment for talent at work and is the means of access to the needed talent.

As with profit, our point of view toward officers' compensation also is strictly pragmatic. We are interested in how compensation works as an energizer of business. The question is, what kind of people are brought

into positions of business power by what kind of compensation, and how does compensation affect the way these people act?

Compensation and profits are more than mere energizers, they are directive energizers. They set the test of success in the application of power. They are both stimulus and response. They are not what business is for, they are not the justification of business activity; but they are so important in getting business properly done that they are sometimes mistakenly taken to be the end and the purpose of business. We can properly deny to profits and compensation the exalted position of being the end and purpose of business, and at the same time recognize the crucial importance of these directive energizers in releasing and guiding the powers residing in the business company.

2. *Profits*

Profit is the excess of selling price over cost. If a thing cannot be sold, there can be no profit. Nor will there be a profit unless the selling price is greater than the total cost of getting the article into the purchaser's hands.

This familiar relationship between selling price and costs, which results in profit, causes profit to serve two exceedingly important purposes. In the first place, profits are a test of whether the thing that is made is wanted,

and whether enough people want it at the price at which it is offered more than they want something else at some other price. If they do not, there will be insufficient sales, and insufficient profits—or none at all.

In the second place, profits serve as a check on costs, and hence as a means of reducing wastes of all kinds. The costs must be brought below the price at which the thing will sell in adequate quantities, and the lower the cost the greater the profit and the greater the possibility of wider use.

The first purpose that profits serve is to make sure that the thing made is wanted by the people. The necessity of making things which must sell directs the energies of a company into the channels of making things which people want more than they want something else. It stops companies from trying to do things that get no public response and that meet no public need. And since most things compete with other things as objects of human desire, and since they compete both in desirability and in price, the managers of business are forced to seek a right price for the things they have to sell.

The fact that the thing made must be sold if there is to be a profit makes the managers of business attend to other matters than merely *making* things. They must give much attention to the *pricing* of the things they have made and to the *selling* of them. The selling activities of a business are informative services which help improve the standard of living, and the pricing process is a delicate and admirable device for letting people decide how much they want one thing as compared with something else.

The selling and pricing of things made by business for the use of people sometimes leads to business conduct of a character that the people, through their public government, have made illegal. Misrepresentation in advertising and false branding have been outlawed as a method of getting sales that will yield a profit. So also, most forms of collusion in the setting of prices are considered contrary to public interest and are made illegal as "conspiracy in restraint of trade." The beneficial influences of profit-making in the production and distribution of things for use must be protected by outlawing misrepresentation of the goods sold and collusion in fixing their price.

The second purpose which profits serve is to reduce the costs of production and distribution and, thereby, to eliminate waste of human effort and of natural resources and to make more things available to more people. The beneficial pressure of profit on cost reduction comes from giving an impulse to efficiency and ingenuity; it provides an incentive for the discovery of new processes and new machines for the elimination of waste motion and unneeded services. This kind of cost reduction results in the use of less human effort and less material in the producing and selling of a given article. Economy in the use of our resources of men and materials, while at the same time maintaining the same or a higher standard of living, serves a valuable social purpose, and the pressure for profits is the principal influence to this end.

Just as prices can be fixed and maintained in ways that are unwholesome, so also can the cost of things be cut

in ways that are considered unfair and sometimes illegal. The setting of wage rates below minimum standards, pressure for output beyond the limits of health and sanity, adulteration and deterioration of product—these and other methods of cost reduction are at least on the shady side. Profit-making by such means must be checked by public regulation.

Profits, therefore, serve a double purpose: first, they direct the activities of business into channels which meet a public response; second, they provide a pressure for ingenuity and efficiency. Profits are needed for these two purposes, whether the profits, after they are made, are privately owned or not. The ownership of profits is a separate question from that of the usefulness of profits as a directive energizer of business power. An enterprise of the business type, producing goods and services for use, whether it be publicly, privately, or co-operatively owned, requires the profit motive and profit statement to make it work and work soundly.

How high can profits properly be? If the goods are sold squarely and priced competitively, if the costs of producing them are governed by intelligence and by the use of fair and legal methods, if there is no direct or indirect public subsidy that makes prices higher or costs lower than the managers of the business themselves could make them, then the higher the profits the better the interests of all are served. A special case exists in the exploitation of privately owned natural resources where the need of conservation for the benefit of future generations should be a reasonable limiting factor on present profits. But, even in this special case, given a public pol-

icy and law as regards conservation, the higher the profits the better.

Unfortunately, public opinion today is skeptical of accepting the highest obtainable profit as a desirable social standard. This skepticism is the result of the practices we have described, which have undermined the prestige of business.

These practices are: improper representation and misbranding in selling; controlled and noncompetitive pricing; exploitation of labor; adulteration of quality; the receipt of subsidies in the form of franchises, tariffs, tax exemptions, and grants of the public domain; and, finally, undue monopoly privileges in the use of patents, trademarks, and copyrights. When profits are made (1) within the law, (2) under competitive enterprise, (3) without public subsidy, or (4) without public protection of exclusivity, the higher the profits the greater the honor to the profit-maker. Under these circumstances there should be no limitation on the amount of profits which a business can make, because the greater the profits the greater the service.

In many cases, business receives direct or indirect public subsidy or public protection of exclusivity. These privileges are neither unusual nor are they undesirable. The American tradition of public co-operation with private enterprise is one of long standing and it takes many forms adapted to many special situations. These subsidies, protections, and immunities, although they have been legally granted, have been excessive in some cases, and they may have been continued over an unnecessarily long period of time. But such errors are errors in the

application of principles that need have only pragmatic justification. We need only recognize that where there is public assistance and special privilege there is also the duty of public regulation and the right of public participation in the final resulting profit.

In addition to the two broad social purposes just discussed, profits serve in three necessary ways to safeguard and to promote the safety and welfare of any particular business. In the first place, they are a safeguard against errors in pricing; in the second place, they are the foundation on which additional capital can be raised as it is needed; and finally, they are the measuring standard against which the efficiency of the management is tested.

The first reason why profits are necessary for a business is to give a margin of protection against errors in pricing. Goods and services are offered for future delivery at an agreed price which is binding on the seller. The company making the sale estimates what its costs are likely to be. In the case of manufacturing, the selling price can be settled and the uncertainties will occur in the costs of the goods to be sold. In the retail business, commitments for the acquiring of merchandise to sell must be made far in advance of the time of sale, and an estimate must be made as to whether at this future date the merchandise will be desirable and whether it will be salable at a predetermined price. In distribution, the costs of goods and expenses can be estimated with fair accuracy, but the selling price and the quantities that can be sold are problematical. In any case, errors in judgment will occasionally be made and the

margin of profit must be sufficient so that over a large number of transactions there is a plus and not a minus resulting from subtracting total costs from total sales.

It follows that the greater the uncertainty of the cost of goods, or of the price at which they can be sold, the larger the margin of profit which must be projected. Efficient management and shrewd forecasting of demand will make profits for some, and under the same circumstances losses will have to be taken by others. But unless the profit differential for the industry as a whole is wide enough to give to the industry as a whole a margin to cover normal human errors in estimating future selling prices and future costs, the position of the industry is untenable. Profits must be large enough to bring risk-taking in pricing and costing within the limits of ordinary business judgment.

The second reason why profits are necessary for a business is to provide a foundation for the raising of additional capital. As a justification for the investment of new capital, profits must be looked at differently, depending on whether the business is an old one with long operating history or whether it is a new one with its record yet to be made.

Let us consider first an old and established business. Such a business must have profits in order to have access to new capital; it must be able to attract the savings of the people to its operations, when additional capital funds are required. These savings can be brought into the company in any of three ways: (1) as the application of the earnings of the company not distributed to the stockholders; (2) as a loan to the company evi-

denced by bonds, mortgages, or other classes of indebtedness; or (3) by sale by the company of the company's preferred or common stock. In each case, a record of profits is necessary if the company is to get the capital it requires.

In the case of raising capital by the investment of undistributed earnings, the profits must have been made before they can be withheld. Further, no management is justified in withholding earnings which belong to the stockholders unless it believes that the withheld earnings can be used to make increased or surer profits.

If the company decides to raise its new capital by borrowing, the higher the profits have been and the longer and steadier the history of the earnings the lower will be the cost of capital. Unless a reasonable and satisfactory record of profit-making has been shown, new capital will not be available on any terms. And even when capital is available, the differences in the costs of capital will be significant, depending on the profit-making record of the company. These differences in the costs of new capital are matters of consequence to all parties at interest in the business.

The obtaining of new capital by the sale of stock to old stockholders or to the public nearly always means pricing the new stock somewhat below the existing market price of the stock already outstanding. This market price may be above or it may be below the book value of the stock; that is, of the historic investment which has already been made in the company. Unless the new stock can be sold at or above its book value, the existing stockholders are paying a premium for the new capital. So, unless the

profits of a company are sufficient to support a market price that permits the sale of new stock at or above book value, the profits are insufficient to support equal treatment of old stockholders with new ones, and again the position of the company is untenable.

Profits are not the only factor which determines the market value of stock, and, therefore, the cost of new capital; but, over the long run, profits are the principal consideration. As a generalization, subject to exceptions in special cases, it may be said that for business as a whole profits as a whole must be considered insufficient unless common stocks as a whole are selling in the market at a price sufficiently above their book value to permit the sale of new stock at book value. If common stocks are selling at a price too low to permit the sale of new stock at book value, access to new capital is too restricted for the health of private business enterprise.

To induce new capital into new business or into an unseasoned business, the expectation of profit must be large indeed. How much return would have to be anticipated to induce the average person to take five thousand dollars out of his savings bank or out of government bonds for risk investment in a *new and untested* business? Would it be 6%, or 8%, or 10%? Obviously, such returns are much too low. Common stocks of standard companies should yield as much as this. Would it be 20%, or 25%? These rates of profit also are on the lean side. Even at 25% after corporate taxes, the business would have to go on earning at this rate for four years in order to return the investment, and at that, the return would be subject to income tax payable by the investor

at the rate of his highest bracket. The plain fact is that new equity capital is ordinarily unavailable to new business on a business basis under present conditions.* By and large, the possibilities of profits are too low, the tax rate is too high, the period for getting the stake back is too long, and the future is too uncertain. Under present conditions, therefore, new business cannot be started on a business basis. A going concern with a good profit record will find abundant capital at reasonable rates, but at reasonable rates it will be loan capital, not capital for the purchase of its common stock.

This is not only a problem for business, it is a problem for statesmanship. If we want new equity capital for new businesses—and even for most old businesses—profit must be higher, tax rates must be lower, and the future must be clearer than it has been in the recent past.

Finally, profits serve a necessary business purpose in providing the yardstick of management efficiency. The management of one company is compared with that of another company in terms of the profits it is able to earn in relation to its capital; the management of a company is compared with itself in terms of what it earned a year ago, or with its predecessor management in terms of the earnings of a previous decade; the several divisions and departments of a company are compared each with the other and with standard profit performances within the industry.

Profit as an evaluation of management efficiency is

*There are many reasons, other than business reasons, for putting capital into business—to get a relative on to a pay roll, to get a job without getting a boss, to marry off a daughter, to establish a loss or to obtain trade discounts. The inside history of why new business is able to get capital would be good reading.

much more significant than mere money or purchasing power. Profit becomes numbers on a score board, the pay-off entry in a competitive game. The incentive to management is not the profit as profit, but the prestige that attaches to having made a good record, to being recognized as being more successful than the management of a competing firm in the same industry, or to having earned more than last year or more than a previous management was able to earn.

For management the profit motive is essentially a competitive motive, which drives where mere love of gain would never drive. The reward to the managers is not primarily the profit, but the prestige symbolized by the profit—success in a competitive game and status among friends and rivals who understand how the score is kept.

Profit as a directive energizer of business deserves more respect than it is sometimes accorded. It would be difficult indeed to find a substitute that would serve the public welfare so well.

3. Compensation

Profits keep the wheels of a business machine turning, and, if the machine is right, keep them turning in the right direction. As with profits, the compensation of the principal officers of a company also helps determine the character of forces within the area of top power in a

company. Compensation has an important effect on what kind of persons will occupy the important points at the source of authority, and on how those persons will discharge their responsibility. The chief officers decide what rules of policy and operations they desire. They issue their rules through subordinates of their own selection and delegate to these agents such of their own powers as they see fit. In addition, the chairman and the president of a company have much to say as to who shall be elected to the Board of Directors itself.

It is easier to take a strictly impersonal attitude toward profits than it is toward officers' compensation. Profits seem to come from nobody in particular and to go to nobody in particular. They can be regarded coldly as one influence among several which are needed to make a business work. But there is nothing impersonal about the compensation of the officers of a company. Their names are put on the payroll by appropriate authority, and the payments go to them as individuals. Furthermore, like other incomes well above the average, these incomes too are subject to comment in public discussion about inequalities of access to the material things of life.

However, as toward profits, our point of view here toward officers' compensation must be pragmatic. We want to know what makes a business work the way it does. Accordingly, we want to know what the influence of compensation is on the management that runs a business.

Compensation of the principal officers of a company may be partly salary and partly other material benefits

and privileges, such as discounts, expense allowances, retirement provisions, and the like. One other form of compensation deserves particular notice, profit-sharing or participation in ownership.

It is desirable that top management should share in the profits of a company. With the growth and maturing of business companies there has been an inevitable separation between management and ownership; and, as time goes by, this separation will produce in business a private bureaucracy whose interest will be more in its own security than in the profit-making adventure of the business enterprise. For this reason, a business should hold or recapture the attitude of ownership by the form of compensation it provides for its top management. Profit-sharing will maintain this ownership attitude in part, but it is a feeble substitute for the substantial fact of authentic ownership.

It has not been easy to devise methods whereby a second or third generation of management can be placed in the possession of substantial ownership interest in an established company. But there are many signs that Boards of Directors and large stockholding interests are aware of the hazards in the trend toward the separation of owners and managers. Efforts to solve this problem should be supported by an enlightened public opinion, and they should not be embarrassed by hostile expressions of those who are jealous or suspicious or who do not understand the dangers to all of having the rule-making of American business fall into the hands of a self-protecting private bureaucracy.

It stands to reason that the higher the compensation

a Board of Directors is able to pay its officers the wider the group from which selection can be made. This does not mean that paying a high compensation will necessarily result in the choice of the best available man for the office, nor does it mean that price alone will secure the services of whomever the directors decide they want. But, given the best operating conditions that the directors can provide, the higher the compensation the more extensive the area of choice.

What difference does a difference in quality in the chief executive officers make in the dollars of profit a business will be able to earn? In a company, what is talent at the top worth?

There are some points about talent which are worth remembering. First of all, for problem-solving, for the arts, and for leadership, you cannot add talents. If a problem in arithmetic is too hard for one boy to solve, it cannot be solved by two boys or ten boys or a hundred boys of ability equal only to the first. If a note in an opera is too high for one soprano to reach, it cannot be reached by two sopranos with the same vocal range singing together. If leadership inspiration is required for a team or a squadron and the leader on the job cannot provide it, two leaders of equal ability with the first also will fail to do the job—in fact, they are more likely than not to produce confusion.

Talents of different people can, of course, be organized to supplement one another if there is a complicated task to be done, a task involving several specialized problems or requiring several special abilities. But for the drawing of all the parts together, for the creative

idea, for the symbol and substance of leadership, the unity of the person cannot be divided, nor can inferior talents be added together to attain a level higher than the highest there is at hand.

Another fact about talent is that small differences in quality make enormous differences in the product. In problem-solving a slight difference in ability may determine whether there is a solution at all. In the arts, there are only small analyzable differences in talent between the superb artist and high mediocrity. In sports, little differences make champions.

Statisticians know this about talent: the higher the talent the fewer persons who hold it. As we move up from average ability, the number of individuals possessing higher grades of talent drops off sharply. This is illustrated by the rays on a common salt-water shell. The average number of rays is eight, with many shells having seven and nine rays. Ten-ray shells occur only infrequently and eleven rays only once in a million examples.

And on top of all this, modern science and invention comes along to multiply the differential productivity of talent manyfold. The scarcity of talent at the highest level becomes much more important because today its productivity can be so much more widely extended.

This change is clearly observed in the popular arts. Today a motion-picture star will be seen by millions, whereas yesterday on the stage he would perform to thousands. Yesterday there was room for high mediocrity, today top talent must be obtained. Furthermore, with the approval of millions at stake, the difference in

profit between great success and good success is out of all proportion to observable differences in the qualities of the offering itself.

The high incomes paid to the stars in movie, radio, and literature are well-justified on pragmatic grounds. The scarcity of high talent, the great differences in productiveness with higher talent, the enormous extension of the application of talent as a result of technical methods of popular distribution, all work together to put a high cash value on people with unusual and wanted qualities.

I am not arguing that these fortunates deserve their greatly unequal returns, nor that these large returns are wholesome for them as individuals, nor for their community, nor for the nation. I am merely stating that today, as perhaps always, talent that is wanted can command a high price because it can earn a high return.

Even if these high salaries can be earned by high talent, is business justified in paying them? Still limiting our discussion for the moment to the popular arts where the evidence is clearest, would it be good business for business to draw the line somewhere as a ceiling for compensation for talent? It is obvious that no single concern could impose such a limitation. The talent would go to a competitor. If the talent is worth its price, failure to use it at that price would be harmful to the interests of stockholders, customers, vendors, and to all the employees. Business must pay talent whatever it must if it needs the talent to increase its profits. Of course, if the business has something to offer to talent other than pay, it will need to pay the talent less.

An industry is benefited by being able to pay high prices for unusual talent, and it is benefited by doing so. In an industry-wide sense, top compensation for special qualifications is really being paid not only to the particular individual, but to all who aspire to comparable positions. All these aspirants—those of the last generation and of the present who could not make the grade, those of the oncoming generation of employees who see before them tangibly an example of what can be done, all the boys and girls who are dreaming about the things they want to do—are the people who are influenced by the top compensation paid for talent in an industry, influenced to the extent that compensation counts. In this way, an industry has available to it the thousands from which the one may be selected. It has thousands and tens of thousands of people spending time and effort and money perfecting natural talents which the industry may someday be able to put to profitable use. And profitable use by the industry means products acceptable to a public which purchases what it wants, better jobs for the rank and file, better outlets for suppliers, and larger dividends for holders of the stock.

High pay for high talent serves a good purpose for all. But the talent must be high. The dangers of losses from wrong and false judgment in selecting talent are large. The responsibility for the use of talent, wisely, boldly, and honestly, is clearly that of the directors and officers who organize the work and who make the rules.

Suppose a ceiling were to be imposed by law on the level of compensation. Since there would be no competition between companies as to level, high talent would

have to be satisfied at the ceiling price, since it would rather work than starve. Yes, but high talent can work part time, and that is exactly what would happen if the rate of pay per month, per year, or per lifetime were to be limited by law. The laws of nature have precedence over the laws of man. The productivity and scarcity of high talent are stubborn facts. The profit of movie and radio companies will be higher with a $200,000 artist half time at $100,000 net compensation than it will with a $100,000 artist full time at $100,000. At the levels where salary limitations would be imposed, the final result would be to deprive the generation of a substantial and irreplaceable portion of the productiveness of its highest genius.

The same logic of high compensation for high talent applies to the positions of the principal officers of a company. The opportunities and responsibilities of these strategic positions call for the talents of problem-solver, artist, and leader, all rolled into one. Even a rather small company can afford to pay high for such qualities; and if it does, it is not likely to be a small company for long. If the field of the company has been a limited one, it is likely soon to find its limitations vanishing.

In paying high salaries for its principal officers, the Board of Directors should accomplish several things. First of all, it should extend the range of possible choice so that the talent it needs may become available. It should be able to canvass not only its own personnel and its own industry, but the entire range of business statesmanship and business management to find the most promising individuals for high command. A Board

should remember that compensation and conditions of work are both important, and that what it cannot give in one it will have to make up for in the other.

In the second place, high compensation at the top improves the quality of personnel that later will be available to the company and to the industry. All this talent does its preparatory work at its own expense. The inadequate levels of pay in the universities and in the civil service have already made themselves felt in the choices of lifework made by students in the colleges, and the results are paid for at great social cost.

In the third place, the payment of high salaries to the principal officers makes it possible to eliminate them without compunction if they do not work out or if a man turns up who could better fill the place. As things are today, there is a tendency to go along with a general officer who is "good enough." The reasons are not hard to find. In the first place, good officers are scarce, and it takes two or three years to know true capacity. In the second place, the present officer is not doing a bad job. His qualifications and character were thoroughly studied before his appointment, and it would be most exceptional if a general officer who had been appointed on grounds of ability were not able to carry on with at least a passable showing. Finally, a general officer who is removed from his office, except by politics or change of ownership, is probably broken as far as his career is concerned. No subordinate executive or employee suffers the complete liquidation which is the lot of a discharged president.

But "good enough" should not be enough to satisfy

a Board of Directors when it comes to high executive talent. The hands of the Board should be entirely free to replace chairman or president. Too much is at stake for too many people to justify continuing with an obvious mistake at these points of authority. The position of president is probably more critical than that of chairman, since, in a sense, he can make more positive and irremediable mistakes. The weakness of a chairman is more likely to be shown in lack of imagination or in undue caution. These sins of omission are difficult to detect, since at the time they occur they have all the earmarks of prudence and solid common sense. It is also more likely that the members of a Board can bolster up a "good enough" chairman than that they can make up for the inadequacies of an inadequate president.

In realistic terms, the hands of the Board will never be entirely free when it comes to discontinuing the employment of the general officers. But the inhibitions should not be increased because the compensation or retirement arrangements for the officers are inadequate. The salary of the president should be based on a possible term of service of not more than three years and his retirement provision should be arranged the day he is employed. If it then turns out that the president, on his merits, does serve a longer term, we can be sure that he is earning his salary and a good deal more besides.

There is no guarantee that by paying a high salary to a president the company will get its money's worth. Errors of judgment, urgency, business politics, these and other circumstances may produce an officer unworthy of his job. A man cannot be made presidential quality by

calling him president and paying him a president's high salary. Accidents in the selection of top officers are inevitable and the Board of Directors should be able and prepared to correct an error if it makes one. Such insecurity may appear to make the job of president less attractive. It makes it less attractive only to the man who is not willing to go along with the Board of Directors in the belief that his appointment is a sound one and that he will be able to justify it by good works. The penalty of error may be high to both parties, but it cannot be as high as the failure to provide the best available talent at the center of administrative decision. The compensation of the chairman may well be less than that of the president, both because of the greater security and because the chairman can use members of the Board to help him in assuming his responsibilities for broad company policy.

The compensation of the principal officers, particularly of the Chairman and of the president, is of immense strategic significance for the company and of minor consequence as an element of over-all cost. It should never be mere payment for applied time, nor a reward for honor earned. The compensation of principal officers is, in a concrete sense, formative with respect to the company's policies and its operations. Like the profits of the company, compensation is a directive energizer in what it brings to the source of rule-making power and in the influence it has on all those whose lives are influenced by the company. Top compensation should be set realistically by the Board of Directors, with no thought in mind other than the good of the company.

VI

Labor

1. People at Work

THE employees of a business, all of them, live under the rules of business. Within these rules they find an area of certainty in which they can exercise responsible choice. In their work, they find the greater part of their opportunity for constructive expression. In the setting of business, they find many of their contemporaries. If they remain long in the same business, the business becomes for them a second home, a place where people and things and the ordering of events afford familiarity, confidence, and the warmth of friendly recognition. In this medium, people grow into what they will become.

Business is, to be sure, only one of the many rulemakers that define the range of choice for the employees of business. Yet, for its employees, business is ever-present and will provide a poor or a rich reward, depending on how the decisions of management affect the common events of day-to-day experience and on the way the problems of management are solved.

What are these decisions of management? First of

all, someone must guess what customers will someday want and how much they will be able and willing to buy at a price; someone must estimate what it will cost to make and to distribute these things; someone must set the first and subsequent asking price; and someone must take the risks of the inevitable errors in these estimates and guesses. These things having been done, the opportunity for employing people begins.

Second, the work of production must be laid out and the work of distribution must be planned. This planning must be done by people who can relate things to processes in a time series, who are informed as to the relevant arts and techniques, and who are able to apply their know-how to the job in hand.

Finally, the plans having been made, they must be executed. The results must be inspected and the adequacy of plant and personnel must be preserved.

All these things must be done by and through individual men and women who are the employees. These employees must be associated in an orderly structure in which each must do his part. Each employee must have the ability to do his job; he must have the will to do it; and, in doing it, he must have the opportunity to grow and to achieve. These considerations define the permanent problems in the management of people at work. These problems are: (1) the organization of individualized talent applied to a purpose, (2) the evoking of effort, and (3) the preservation of personal dignity and freedom within a frame of order.

As long as we go on wanting things we cannot make for ourselves, as long as we want these things with econ-

omy in the use of labor and materials, as long as we shall continue to exercise personal choice in selecting the things and services we want to use, just so long the present problems of managing people at work will continue—regardless of what emerges in terms of balance of power and spheres of influence of our many governments, public and private. The controls of the state may be increased or diminished, the voice of labor unions in fixing the conditions of work may become stronger or weaker, the business managers may make their rules with greater or less autonomy, ownership may reside at one point or another—no matter how these forces of authority combine, change, and recombine, the old problems and the same problems of managing people at work will persist.

2. *Talent and Effort*

Skill and will are separable aspects in the management of people. The distinction between talent and effort is the distinction between skill and will. This distinction can be made on a practical basis. Some people cannot do the things they would like to do, and others will not do the things they can.

The first task in the management of people is the search for skill and the proper assignment of skill to work. This first task involves all the techniques of vocational guidance, vocational selection, and vocational

training. The schools and business, each has its own work to do—and it will be better done as it is done in co-operation. At some point the period of formal institutional schooling must end, but it need not end as abruptly as it does today, nor as late.

So, too, the period of vocational training in business might well begin sooner and extend much longer, as much longer as there remain things to be learned and the capacity for learning them. Properly organized, this vocational training can be given by business in its own profit-making self-interest and not as an expensive gesture for the sale of public goodwill. Curiously, vocational training is something which labor unions rarely ask for, and provision for vocational training has seldom been made a part of a union contract.

One interesting example of provision for technical education is to be found in the agreement between Local #2, U.A.W., C.I.O., and the Murray Corporation of America, in which it was agreed to educate the Union's Time Study Stewards through the services of Stevenson, Jordan & Harrison, Inc., management engineers.

What could be more important for individual freedom than vocational guidance, vocational selection, and vocational training—the discovery of what an individual is likely to do well, the provision of his chance to do it, and the improvement of his skill through supervised experience? The command of the individual himself and of his world—his capacity for freedom—is extended or limited at this crucial point. It is a point that business can do something about in its own interest. Our loss of perspective is vividly illustrated by the present neglect

by business of the search for skill, its development, and its precise application.

The second task in the management of people is the evoking of effort in work. The will to do depends on many things. In creating that will to do, the proper assignment of skill is important, since people like to do the things they can do well.

Beyond the skillful assignment of skill, there are the problems of compensation. How much shall tne pay be, and how shall the payment be made? Shall payment be made for the time put in or for the amount of production turned out, or shall it be based partially on each? Shall payment be made to an employee as a depersonalized member of a working group, or shall it be based on individualized talent and output? Shall the payments for work be made in money or in privileges, or shall they be made partly in each? Decisions on these points require basic judgments in the management of people. They fix the amount and manner of return for effort. They fix for each employee his share of the production that is being achieved by division of labor throughout the world. The amount and manner of payment, its adequacy and fairness, is at the heart of getting people to do the best they can. What has been said in the previous chapters about the compensation of officers is true also about wages; wages should be as high as they can be in terms of obtaining the most desirable talent and the optimum application of effort. It is the problem of management so to organize the work that high wages can be paid profitably.

The giving of effort by people depends on their re-

lation to those in authority, principally to the immediate source of command. It depends in part, also, on all who stand above and who give to the business its character and its reputation. Inadequate and clumsy supervision has caused gross waste in business through reduced application of effort. There have also been tensions and imposed restraints on management authority that come from revolt against unfairness, insensitivity, and bad manners.

But the great test of the will to do comes in time of crisis. It comes with the need for special effort, which must ever be unplanned. The requirements for this extreme motivation are habit—the habit of discipline, of unconscious response to the direction of others—and loyalty—the impulse to find self-realization in purposes not one's own. Habit and loyalty are the common gifts of human nature to all government and, therefore, to the management of business as well. They are gifts to be won by an understanding supervision that has pride and insight in its responsibility for protecting human values.

Finally, the act of will is most effective when it is freely given; when, to the instructions or to the given plan of work and reward, there is added the consent of the man who works. This consent cannot be imposed, it must be won. It may be won in many ways by attention to the amount and manner of pay, to the conditions of work, and of supervision; by the establishment of good habits and of goodwill.

Consent to the conditions of work sometimes comes because of knowledge that in the fixing of these conditions someone, a union perhaps, has had the workers'

special interest in mind—especially when other interests are in conflict. One great potential value of the labor union to production is thrown away unless collective bargaining can be harnessed to yield its return in the consent of people to the day-to-day requirements for effort in the application of skill to production.

Beyond its basic interest in skill and will, a management must have concern for its employees as persons, as individuals who have accepted, for the time being, the authority and the setting of the business that employs them. The preservation of the dignity and freedom of the individual in a frame of order is a third permanent problem of management in a democratic country. It is a trust which business in the United States assumes when it accepts subordinate powers of rule-making under our democratic state. The proper application of skill and will to production is necessary to the full growth of individual personality. Business takes long steps toward this objective as it is successful in the organizing of talent and in the evoking of effort.

The authority of business has as its first purpose the production of things for use. But collaterally and inescapably the rules of business, which are aimed at production, also establish the frame of order for those who do the work. Accordingly, the rules of business serve two purposes and must be judged by two standards, the standard of efficient production and of personal freedom. The rules of business must meet the test of both.

3. Distortion

Today, as a result of the unsettled balance of power and undetermined spheres of influence between business government and trade-union government, there is confusion in handling the persisting and inescapable problems of managing people at work. The essential goals in the relations between employees and the business that employs them have been distorted in the hurly-burly of conflict. Private business government and private labor-union government have been playing for position as rule-makers. Public government—federal, state, and local; legislative, executive, and judicial—has been used and abused by these two contestants for power over the conditions of work. New laws, new decisions of the courts, new administrative rulings, have brought with them their inevitable quota of uncertainty, confusion, and disorder.

Within the shifting frame of public law, these two rival private governments have traded, threatened, cajoled, and used sheer force when it seemed advantageous to do so. An old balance of power was being defended, a new balance of power was being fought for, and the end of the struggle is by no means near. During wartime, public government has, for the moment, asserted its supreme authority. But with the coming of peace among nations, the strife between private governments, between unions and business, for power over the work-

ing life of working people will be resumed. The old weapons have only been laid aside. Meanwhile, new weapons are being forged, and ground mines are being skillfully planted beneath the highways and bridges to production.

Under conflict, perspective and emphasis changed. Attention of management has been forcibly drawn to contracts, negotiations, demands, decisions, picketing, boycotts, arbitration, jurisdictions, and elections. Gone is an earlier preoccupation with vocational guidance and vocational training; with fitting the job to the man and the man to the job; with health, nutrition, and fatigue; with loyalty and friendliness; with building up a business family and a business home. Psychologists, psychiatrists, physicians, hygienists, and dietitians are subordinated; and their places have been taken by economists, statisticians, lawyers, and politicians. Under the pressures of the changed emphasis and perspective, the humaneness and the kindliness—and the shortcomings too—of the feudal, paternal business regime are passing away.

But change of emphasis and of perspective does not change the nature of Adam, of the man who does the work. He still has his individual and personal qualities of mind and body, things he can do and things he can learn to do. He still likes to help make things, and he likes to loaf. He wants companionship and a good boss.

He, too, now finds that he must take into account a new rule-maker, the union. He finds that he has become a member of a new order; that a new government has taken him over; that in addition to family, church,

and employer, in addition to policeman and tax collector, a labor leader can tell him what to do. He finds that in some strange way the leader is said to be of his own choosing. He finds that labor government is in conflict with business government, and that because of the conflict he gets benefits he could not get for himself: better pay, shorter hours, more job security, and a chance to complain about his boss. These things are all good—all but the conflict, the conflict which has distorted the perspective of management and worker alike in their understanding of the essential part that business plays in the lives of all who work in business.

4. Conflict

It would not be realistic to hope that we can move into a future of orderly relations between business and labor unions without a period of serious conflict. The basic issues of power and responsibility over the conditions of work in business have not been settled. Many leaders of business are unwilling to share with any other government—public or private, state or labor union—power over decisions that affect the operations of business, if they can avoid it. These decisions affect profits and, in affecting profits, they affect the value of the property that is being managed. It is the contention of these managers that, since the property they administer is private property, its use in production is the exclusive

prerogative of the owners; and that the owners have delegated to them, the managers, authority over its use. These managers would like to hold to the position that it is neither right nor wise to share this responsibility with agents not of their own choosing.

But at this point the public laws of the state and the nation interpose limitations on the powers of the managers by placing restrictions on the use of private property. For example, private property cannot be used lawfully to injure the health or morals of the community. And recently, under the Wagner Labor Relations Act, public law requires that under specified circumstances private business must be administered under collective bargaining by representatives of the workers' own choosing.

Some managers of business, acknowledging the authority of the existing law, do not admit its wisdom as a solid basis for the administration of private business property. They hope and expect that the law will be changed, and they are prepared to spend time and effort to re-establish an exclusive jurisdiction over the operating rules of business affecting their employees.

Other managers hope to move, not back, but on. They, too, believe that the present laws are temporary. After the war they expect a change in present legal requirements, which will give them some relaxation of the restraints on their own actions and some increase in the accountability of labor leadership.

On the side of the labor unions, there is also evidence that the war in the world has forced a truce and has not brought a peace. As with the managers of busi-

ness, so, too, within the leadership of unions, there are differences of opinion as to the changes that must be made. Issues of security and seniority, of the balance between wages and leisure, of participation with management in supervision, these issues remain relatively quiescent—but for the time being only.

The thorniest question of all as between management and unions is the question of the union shop.* Most unions urge the necessity and propriety of the union shop. They contend that in any company, all classifications of employees who are represented in negotiations by labor unions with management must include only employees who are members of the union. The argument is that, since it is through the union that benefits and privileges to the employees have been obtained, and since these advantages become equally available to all employees of the same class, it is only fair that all should share the costs and discipline by which the benefits and privileges are made possible. If a worker is going to receive the good things that private labor-union government can win, he must associate himself with that government and must abide by its rules. Even if an employee chooses to forgo the benefits that the union makes available to him, nevertheless, he must join the union if his employment brings him within the area of labor-union jurisdiction. Otherwise, the clarity and certainty of negotiations will be diminished, since nonmembers, who are in fact aliens to the union's govern-

* The conflict with reference to the "union shop" applies also to the closed shop" and to a greater degree. The "union shop" requires that all persons employed by the employer must become members of the union; the closed shop" requires that only members of the union may be employed.

ment, may not recognize, and cannot be forced to recognize, the labor union's rules and rule-makers.

It is, therefore, easy to understand why the unions insist that a fundamental of trade-union rule-making is the union shop. In entering collective bargaining with a company, a union usually attempts to obtain an agreement that any worker the company may employ shall become a member of the union. Its purpose in doing this is, as we have said, to prevent non-union members from employment in the company on terms which may prejudice the agreement or the union. It feels secure and effective only when, without exception, all employees of any classification organized in the company are on the union's membership rolls and under its jurisdiction.

There are today about 39,000,000 jobs in the United States subject to unionization. About a third of these—more than 13,000,000—are now covered by collective agreements. For 6,000,000 of these jobs there is a union shop. These jobs cannot be held by any worker unless he is a member of the union which made the agreement. In many industries, few jobs are available to the employee who is unable or unwilling to join the union.

Ordinarily, union membership is open to every worker who is employed, or who may be employed, within the trade covered by a given union. The union's national constitution defines the type of worker who is eligible to membership. The employee applies for membership in a local union. His application is taken up by a membership or examining committee. Often the members of the local vote on the application at regular membership meetings, but they usually accept the commit-

tee's recommendation. Sometimes the local is dominated by a leader who may be the business agent, the secretary, or the president. In that case, his decision is final. Once accepted, the new member must pay an initiation fee. This is seldom high enough to keep out members, and usually arrangements are made for installment payments.

These are important rules. They work well as long as the trade-union is open to all workers in its jurisdiction. But many unions are not open to all workers. A number of them keep out Negroes, aliens, and women. Some unions also exclude workers whose political beliefs they do not like. To keep out people because of their race, color, sex, citizenship, or political beliefs, where there is a union shop, means to deprive them of the chance to earn a living at their occupation. This is great power badly used.

In addition, there are "closed unions" which limit the number of full-fledged members. They make it hard for outsiders to join or to gain full membership rights by undue regulation of apprenticeship, by charging initiation fees deliberately designed to keep out new members, and by issuing permit cards to nonmembers to work on union jobs without giving them membership. Here, again, the union exercises an economic monopoly to the detriment of workers in its jurisdiction.

Another difficulty which has arisen in union rule-making has to do with the locus of power. In many unions, the rank and file has a say as to the rules that are made and the executives chosen to enforce them. In others, the executive board, and often a single leader,

accumulates absolute power which deprives the members of direct or indirect participation in decisions vitally affecting their interests.

Opposition to the union shop by business is the rule and not the exception. Such opposition is taken on several grounds. The first and most common objection to the union shop raises deep questions as to the position of the individual in organized society. It is insisted that any man should be able to take any job he can get without paying some outsider for the privilege of working. Fundamentally, this reason springs from an objection to having more than one private government in a position of responsible jurisdiction over the rules of business as they affect business. If it is admitted, as I think it must be, that the labor union has a proper and necessary function in the establishment and enforcement of the rules of pay and work, then it seems inescapable that those who benefit may fairly be required to share the burden. The privileges and burdens of citizenship in nation and state are not optional; and if we understand the clear analogies between public and private governments, we must acknowledge the propriety of labor-union efforts to eliminate "aliens and outlaws"—by persuasion if possible, by contract if necessary.

A second objection to the union shop has more force. This objection is that the time is not yet ripe. It is true that much insincerity hides behind the cloak of postponement; nevertheless, the reasons for this second objection are sufficiently compelling so that they must be examined in some detail.

The reasons for contending that the time for the

union shop has not yet come are three: first, that the rule-makers of the labor union do not rule by consent of the employees; second, that, as of today, the leaders of labor unions are in general not competent to use wisely the power of the union shop in rule-making; and third, that labor-union government under the monopoly conditions of a union shop has not been adequately articulated with the public government from which it derives its authority.

The first reason for saying that we are not ready for a union shop is that the government of labor unions does not truly represent the choice of the governed employees. The circumstances under which collective bargaining has been established by labor unions in many companies are well-known. Threats, intimidation, misrepresentation, forgery, humiliation, and even physical force, all have been used from time to time. These alternatives to argument have been used more frequently than the excusable exception that is bound to occur when conflict and rivalry run high. The law requires that a union must show a membership of 51% of the employees of a legally recognized classification of employee if it is to have the authority for collective bargaining. And this requirement has caused union organizers to use measures for getting members far stronger than those of example and persuasion. This is not government by consent.

Even when 51% of the employees were proved to be union members, the employer was impressed by his responsibility for the 49% who were not. This minority was made up of many of the most "loyal" employees; the old-timers; the strong-willed, stubborn element who

would not be driven where they did not choose to go; the snob faction who looked with contempt on unions and union leaders and felt that to join a union would be socially degrading. The manager of a company rebelled, often with sincerity, at the thought of "selling down the river" the large or small minority of employees whose outlook and behavior he found highly congenial. It was bad enough to have this minority represented by the union leadership which they had refused, but to force them into the union—subjecting them to the payment of union dues and to the exigencies of union discipline—seemed incompatible with his views as to the rights of men under the Republic. The union shop, accordingly, violated both the personal wishes of the manager as a company executive and also deep moral principles which have their roots in a general belief in government by consent.

The absence of government by consent under union organization may go beyond the initial organization and establishment of the union in a company. The management may observe that the union, even after it has come into existence, does not represent the membership; that the basic provisions for the selection of members and the election of officers that would help assure consent to the union's rule-making powers do not exist; and that when these provisions do exist, they are frequently brushed aside. The labor leader in these cases is, therefore, not a leader in a psychological or moral sense, but maintains his position by force or misrepresentation; promising benefits such as advances in pay, shorter hours, less work, more security—although these benefits may be

known by him to be not in the best interests of the company, and even not in the interests of the employees themselves.

A manager, therefore, hesitates to agree in negotiations to a union shop when he believes that such an agreement would increase the hold of a leader whose power is already irresponsibly held. In spite of the fact that there are examples of authentic leadership in labor unions, the conditions of forced membership which have been associated with the recent growth of unions in this country cause managers to resist the union shop. Even when these managers accept the principle of collective bargaining as a desirable check on the unlimited discretion of management, they feel that more time and more ripening is desirable before the union shop is imposed on all workers of a class, either by contract or by force of law.

The second argument that is given against the early establishment of the union shop on a more general basis is that labor leadership is not competent to use this great power wisely. It is argued that the talents that make a good organizer do not necessarily qualify a man as economist, statesman, and negotiator; and that, for better or worse, the present generation of labor leadership is heavily loaded with men whose principal talent is to get their unions organized and then to remain on top of them. When it comes to responsible negotiations for the basic conditions of work in a company or in an industry, these leaders may turn out to be ignorant or corrupt, or both. Even when the leaders themselves are competent, they may be forced for the time being to work through sub-

ordinate or local leadership that is both stupid and vicious.

Does this argument rest on an unfair double moral standard, one code for labor leadership and another code for business? Certainly, the record shows business leadership as corrupt as that found in labor leadership—as unsavory, if not always so dramatic. Certainly, too, the records of the bankruptcy courts show much ignorance of economic conditions on the part of businessmen.

The answer is that we do not impose a double standard. The question is addressed to the competence of labor leadership to use the great *monopoly* powers of the union shop wisely. If we are asked to give a business or an industry broad monopoly powers, we should look carefully at the records of the men to whom these powers are given. We should expect in these individuals intelligence, energy, and honor. If it were true that the inadequacies of labor leadership expressed the necessary consequences of the beginning of a democratic process, we could bear with the situation while it lasted as part of the hard way to responsible freedom. But since it is contended that the rulers do not rule by consent, and that they are inadequate to use monopoly powers wisely, management prefers to withhold its approval of the too-rapid extension of the authority of the union shop.

The union shop as a monopoly raises a third set of considerations which argue for caution against its too-rapid extension. These considerations relate to the position of labor-union private government in the scheme of government generally.

The union shop establishes for a union a monopoly

which has two aspects: (1) a man cannot work unless he is a union member in good standing, and (2) an employer cannot employ a man who will not become a union member. As a result of these prohibitions, the rules of the union rule-makers can be enforced absolutely as long as the rule-makers can hold their positions, and as long as the union shop can be kept closed. The rules can be enforced absolutely, because violation by a member would cause him to lose his membership and therefore his chance to work, and violation by an employer would cause withdrawal of all labor and extinction of the company by bankruptcy or merger.

The rules enforceable by the union under the union shop may include all circumstances and conditions of work as they apply in general to a group of employees. These rules may include wages paid, hours worked, vacations and leaves allowed, seniority privileges, output permitted, machines to be used or not used. Going beyond the conditions of work, which are the true concern of a labor union, the rules may be improperly extended to cover the sources from which the employer buys and the prices he charges for his output.

The extension of the union shop and, with it, of the unregulated monopoly position of the labor union creates an absolutism that is incompatible with government of the democratic type, where rule by consent and not rule by force is fundamental law. Since it is improbable that in a conflict between the government and labor unions the unions will finally be able to hold on to the absolutism inherent in the union shop, it seems inevitable that the labor unions, in winning the union shop, will win

government regulation of unions at the same time. The tolerance with which monopolistic practices by labor unions is viewed today is a passing phase. It is already evident that union members themselves resent the high prices they are forced to pay as a result of imposed and restrictive rules of other unions.

The public regulation of unions will cover at least three matters:

(1) Membership in unions. Membership restrictions will not be permitted on grounds of race, creed, sex, or politics.

(2) Costs of production. Excessive costs of production will be prohibited by public supervision over wages, hours, and conditions of work, guarding against agreements that impose needless and wasteful restraints on management discretion, feather-bedding, and other devices designed to spread work by enforcing inefficiency.

(3) Reporting and auditing of funds. The funds of unions will be required to be reported and audited in such form and detail as some public agency will determine.

Such regulation is the inevitable concomitant of the general extension of the union shop. Until the majority of labor leaders understand that this is true, and are willing to accept such regulation as the price of a union shop, it seems unwise to rush too rapidly into this type of private government. The result of too much haste, of creating the power in advance of understanding, would be bitter, wasteful, and unnecessary strife between the unions and the state. In such a battle much might be lost

that now contributes helpfully to the promotion of order and freedom.

And so, in the unsettled and ambiguous pluralism of union, business, and state—the expectation is for a period of conflict and disorder. Business will attempt to protect its present powers against union interference; the union will attempt to exact from the state the right of exclusivity which the church has already lost. In this struggle for power there is no natural law, and there can be no judge. The new arrangements of power will emerge as a product of the design and accident of conflict.

5. *Perspective*

Someday conflict will be superseded by order. The accommodation of business government to trade-union government will have largely taken place. The labor unions will have achieved accepted status and defined responsibility. Some of the present rules of the business rule-makers will be modified and restrained by agreement with the union rule-makers. The union will help police the agreements. At appointed times and under orderly procedures the union and the business will draw up new treaties for their governance.

The labor unions and their leaders will perform their functions like any other recognized government, quietly and acceptably. Their jurisdiction will be what it will become. From time to time, dispute and even strife

will flare up as cultural and technological changes blur the sharp definition of a hitherto established boundary. Just as today there are occasional sharp struggles between public government and business government as to field of authority, or even rare clashes between church and state, so also in an established scheme of broad understanding there will be points and periods of conflict between labor unions and business and between labor unions and government.

Except for these occasional points and periods of conflict, the labor union, like any other established government, will not enter vividly into the consciousness of the governed. Like these other governments, it will use symbolism and ritual to keep fresh in the common mind an awareness of its essential and continuing purpose, and to obtain consent to its rule-making and its disciplines.

In relation to the management of business, the labor unions will take a place not unlike that of its auditors. Like the auditors, they will participate with authority in the making of some of the rules. But the problems of management caused by labor unions will be neither more frequent nor more troublesome than those raised by the auditors today.

The area of labor union government will then have taken form. A new pluralism will have been established. The rules of the labor union will stand along with those of business, family, church, and state, providing quietly and acceptably their part in the structure of order within which individual freedom may be sought and found.

Conflict will no longer distort the perspective with

which a business looks at its own influence on the lives and work of its employees. Once again the human element in business will assume its rightful place. The center of attention will not be twisted by disputes as to who should make what rules. Instead, the operations of the business and the part taken by each individual employee will stand out in clear detail. The attention of management will then return to the deeper and more intimate problems necessarily associated with the organization and administration of human beings in a collective task of production.

VII

Business International

1. *Trade in the World*

WE have seen that in the relations of private business government and private labor government, unresolved issues and confused jurisdiction over the governed have caused conflict and loss of perspective. In yet another area, unsettled relationships among the rule-makers result in distortion in the application of business effort in the realization of its humane possibilities. This other area is the field of business international, and problems here yet to be resolved are those which arise when a business carries its activities beyond the borders of the national state from which it derives its own rule-making powers.

For our purposes, in studying the place of business as an instrument of human freedom, it is desirable to observe the international activities of business in the broadest terms. These activities fall into three types: first, the extension of the powers of a particular business beyond the frontiers of its own country; second, export and import of the products and services of business

between national states; and third, the association of private business governments for the regulation of production and distribution in the various countries of the world.

The essential circumstances that dictate the high desirability of world-wide commerce and healthy international business are well-understood, and need be mentioned only briefly. The world was not created with its lands divided by political boundary lines, nor is its wealth distributed evenly among the national states. The surface resources of soil, water, and climate have changed greatly over the centuries. The subsoil minerals which are indispensable for our industrial revolution of the last two hundred years may or may not be close to these surface resources. The advances of science and industry create new needs for raw materials which may be produced in areas far removed from their final use. The automobile, for example, finds its greatest use in mass consumption on the temperate plains, and suddenly an agricultural product of the tropics—rubber—must be produced in enormous quantities and transported thousands of miles to meet the new demand.

The people of the earth also are unevenly distributed among the nations. Natural barriers such as oceans, mountains, desert, and jungle confine the movements of people and divide them from one another. Cultural barriers such as language, custom, and law create groups that bind themselves together from within. The talents and capacities of men differ widely, and special knowledge and skills in the making of things for use arise in special places. These talents and skills, being passed on

and perfected from generation to generation, come to be the genius of particular nations and peoples. Yet what each can do well is useful to all.

From earliest history the commercial trader has wandered over the face of the earth. He brought to people things greatly wanted and took from them in exchange other things which could be spared. In doing this he gave what was scarce to some and took from them what was abundant, in the expectation that what he took would be wanted by other people elsewhere. He served to make the resources of the world and the special talents of people available where otherwise they would have been lacking, or perhaps even unknown. The reward for his effort was obtained in the margins he could exact in completing the exchange.

The earliest commercial trader may have been an individual, a society, or a group of friends in partnership together. Later, to facilitate and to regularize the multitude of transactions which had become indispensable for the people's needs, great corporations such as the East India Company and the Hudson's Bay Company were chartered to carry on foreign commerce and were given broad powers of decision. Today the commercial trader is ordinarily an incorporated business or legalized partnership with its managers and its rule-making authority. Thus it happens that the vital wealth-creating task of exchanging resources, products, and skills among the national states of the world is undertaken by private governments which are chartered by one or another public government.

The political and economic rivalries of recent gen-

erations have imposed uneconomic barriers to international trade. The moral and political reconstruction of the world must include progress toward the fullest international exchange of goods and services. We want to restore the useful services provided by the commercial trader who wandered over the face of the earth, exchanging what was scarce for what was abundant. But when the trader international comes again it will not be in a world of mysterious places and creatures, but in a known world organized to give freedom, security, and well-being to all.

2. *Power Beyond the Borders*

When a business goes beyond the borders of its own country to carry on its own business activities it inevitably creates a special set of power relationships. We must remember that the private business company is a nationalized institution, and that as a private rule-making agent, its decisions are validated by the authority it receives from the national state. In consequence, it turns naturally to its own national state for protection and assistance, and the national state turns to it for help in the carrying out of national policy—economic and political.

As long as business stays at home it usually recognizes the superior position of public government on issues of a purely domestic character or affected by a na-

tional interest. This superior position is accepted as a matter of right and not merely as a matter of force; although it must be conceded that the superior power position of the national state, as compared to that of private business, keeps many conflicts from arising because the outcome is evident in advance. Business may not like the laws passed in its own country regulating conditions of labor, control of prices, and restraints of trade, but business does not question the propriety of regulation within the law. Even in those cases where business groups have taken over control of public government by the influence they have acquired over public officials —as seems to have been the case in Germany, and as sometimes happens to us in local government—even in these cases private business operates through the form of public government, and, in its own country, does not usurp the dignity and status of the state.

Under the stress of war, revolution, and depression, the offensive and defensive alliance between private business and public government has become closer and closer. In the Soviet Union business and government became one. In Germany tendencies already well advanced were accelerated after 1933, and business and government functioned as one—certainly as far as international commerce and political propaganda were concerned. In the United States the depression brought business to the government, asking for increased protection against foreign competition, and resulting in the Smoot-Hawley Tariff Act of 1930. Business asked for protection against domestic competition in 1933, and got the NRA. The threat of war, and war, caused the government to

draw private businesses in the aviation and communication industries into the orbit of national foreign policy.

In business international, the private and public rule-makers—businesses and governments—develop conflicting patterns of power relationships. In foreign trade, a single business, chartered in its own country, must issue and enforce its rules to conform to the public laws of one or more foreign national states. If a business does not like the compulsions of an external and alien national power, it may seek to associate its own national government with it in securing justice or in imposing its own will.

Deep moral and psychological transformations take place when business crosses its own national borders to do business. When operations are extended abroad, the attitude of the business management toward a foreign public government and toward alien people is different from the attitude it takes toward its own. In relation to the foreign state, the business manager is less inclined to acknowledge any moral right of government to a superior power position; the foreign state must have sufficient power to enforce its own laws. The manager of a business may also feel that his own country has an obligation to get for him from the foreign state, by negotiation or by force, the powers and immunities he feels he needs to compete successfully with local businesses and with those of the nationals of other countries.

If the workers, suppliers, customers, and stockholders of a company are citizens of another country, the attitude of the management of a business toward these people is different from what it would have been had

they been citizens of his own. The degree of change in any particular case will depend on the particular manager. When a business manager's respect for the dignity and welfare of foreign peoples and foreign governments is weak, his business, when it operates abroad, tends to loosen conventional restraints on predatory action and to magnify the relative power position of his private business as against that of the foreign public government. With this change comes an increasing growth in the feeling of prestige and authority of the business manager. He no longer feels, as he does at home, that he is subordinate to the national state; but he may feel that his status is equal or superior to that of the public authorities of the foreign state in which he carries on his business. As a result, the established and orderly relations of business and government, taken for granted at home, tend to break down. Conflict and rivalry between public governments and private business arise, and neither government nor business is willing to yield status to the other.

Over the centuries the record of private business operating abroad is filled with instances of ruthless, inhumane, and corrupt pressure on native authorities and native institutions. It is true that business international has taken with it, to these foreign lands, lasting material benefits—but at a fearful cost to the people of the world. The destruction of primitive cultures and of the orderly processes of primitive social arrangements are poorly compensated for by a more protracted and disorderly life adorned by gadgets.

In recent decades there has been a change for the

better, in recent years at an accelerating rate. Sheer barbarity has been practically eliminated as defensible policy. But it may come as a shock to some to know that conferences of national states devoting efforts to the suppression of trade in African slaves were held as recently as 1885 at Berlin, 1890 at Brussels, and 1919 at Saint-Germain. Substantial correction of the traffic in opium awaited the emergence of an international government, the League of Nations. The conditions tolerated as late as 1939 in the colonies of some of our best people illustrate the dangers of irresponsible and unregulated business international to human freedom.

These evils of business international are the result of an understandable tendency to moral insensitivity when business is done in a foreign state that does not command respect, and when the persons who are injured are thought of as "foreigners" and not identified as part of the manager's own human family.

The picture is by no means entirely dark. Business operating abroad contributes good as well as evil. Between countries that have attained high standards of political order and a fair equality of living standards and productivity, between countries in which there is respect for each other's citizens as persons, beneficial international trade goes on without harmful cultural disturbance. This condition existed in Western Europe prior to 1914.

And even between countries with different standards and cultures, experience shows that international business may be a helpful influence in improving the welfare of a foreign people. Obviously, when an industry has a

profit interest in raising the standard of living in another country, the companies in that industry will go a long way in establishing high standards of operations and working conditions. This has been true of United States- and Canadian-owned public utility companies serving Latin America. On the other hand, when an industry has a profit interest in maintaining low costs, as in the case of the extractive and raw material industries, the companies may be negligent or obstructive in instituting standards of business practices which they would take for granted at home. But even here we have examples of strong companies, such as the oil companies in Venezuela, which have been solicitous for the long-time development of the foreign country in which they are operating. These companies have respected the political integrity of the country and have contributed sincerely to measures for the welfare of the people.

The good examples provide clues to the methods and conditions under which business abroad can be carried on both profitably and humanely. If we are optimistic, we can take the good examples as a sign of the way business international is likely to evolve. If we are cynical, we can discount these evidences of private statesmanship as the self-conscious welfarism of companies that can afford to be good. If we are realistic, we will recognize that the investment of a company operating abroad is affected by the growth of popular political groups and movements, the opening up of horizons by radio and motion pictures, the vulnerability of foreign commercial operations to domestic political attack, and the unwillingness of the home country to intervene with armed force.

However, in the end, the only secure foundation for the building of international business is the voluntary subordination of the rule-making of private business to a moral code. Unless there is some standard of value that cuts deeper than mere greed, who can say when a particular business manager will value the short run higher than the long—or whose benefit will be taken as the practical test of policy? Such a code may be imposed on business operations abroad by the superior power of a foreign state, or these principles may emerge as a consensus in a world community of national states, a frame of order within which international business will find a common law and a code of conduct. Or, more simply, the moral code that sets the standards for the rule-making of business when it goes abroad may be nothing more than the extension to the world-wide activities of that business of the humane practices which have been freely accepted at home as a matter of right and justice.

3. *Products Across the Borders*

When the products of business go abroad, another set of complications arises, among them the toughest and the most irrational in the whole adolescent world. The reason the products of business go abroad is because they are wanted by the citizens of the country that receives them. We in the United States want Irish linens, Scotch woolens, French champagne, Chinese embroidery, Bohemian glass, Argentine beef, and Italian wines. If these

products of other countries are wanted here in the United States, why shouldn't our people have them at the price for which they are available? Why should the power of the national state be invoked to keep them out, or to add to the price at which they would otherwise be available a tariff duty that makes us pay more than the businesses of other countries require in order to sell these things to us at a profit?

The United States is not the only country that puts up barriers to the exchange of the products and services of other lands. Practically all countries impose tariff or other barriers to prevent the people of their own country from benefiting from the skill and enterprise of people not their own. Why should this be?

There are two compelling reasons why foreign products are excluded from a country, or why they are admitted in quantities less than the unrestrained flow of trade would bring. The first reason is that these imports absorb foreign exchange, which is available in limited quantities only and is needed for other products more urgently required in the national interest. The second reason is that they compete with similar products made at home.

Taking the first point first, there is good reason why a country with a limited amount of foreign exchange should put up bars against the importation of certain kinds of products. We in the United States are not sensitive to the problem as it faces other countries. Throughout our history, the demand for American agricultural and manufactured products has been so great that we could buy abroad everything we were willing to

accept. Except in wartime, we have never had a foreign exchange problem caused by our spending more dollars abroad than the people of other countries wanted. We can buy abroad all and more than has been our custom. The world demand for our agricultural and manufactured products makes others want all the dollars we pay to foreigners for the things we buy from them.

But some countries are not in our fortunate position. Take a country like Yugoslavia as a case in point. Yugoslavia has a certain number of products which she can export—grains, copper, ceramics, and textiles—but the variety and quantity is limited at the present stage of industrialization of the country. The foreign currencies coming to Yugoslavia for the purchase of these exports are all that are available currently for the imported goods which are required, and for payment of interest and for providing a sinking fund on the country's external debt. If Yugoslavia can and wishes to borrow abroad, additional foreign currencies may be made available to her, but in the end these loans, too, will have to be paid off from the proceeds of exported products. Tourist expenditures and remittances from nationals working abroad will help some; and for many countries they may be made important.

But, finally, a balance will have to be struck and the government of Yugoslavia will have to decide whether, everything taken into account, the people in the country can be permitted to import all the things they want. The people of the country may have all the local currency they need. They may have plenty of dinars, and yet the country may not be able to exchange

these dinars in the desired quantity for dollars or pounds sterling. This would necessarily happen if the sales of products of Yugoslavia abroad were insufficient to provide the needed amount of foreign currency.

When a government finds that there is a shortage of foreign exchange to cover all the importing its people want to do, it is proper that a decision should be made that some imports are more in the national interest than others, and that such foreign exchange as is available should be allocated to the essential imports. It might be decided, for example, that cosmetics, and consumers' durable goods, such as automobiles, radios, and vacuum cleaners, were less necessary than dynamos, railroad equipment, agricultural equipment, and citrus fruits. If so, tariffs and embargoes might be placed on the less necessary imports, both to reduce the quantity of such goods coming into the country and also to stimulate their production at home. Such measures are taken in order to protect a country's capacity to pay, and to accelerate its capacity to attain higher levels of production before the people enjoy the use of international products serving little or no constructive national purpose.

The United States must be prepared to see a considerable amount of such restriction on imports by foreign countries in the postwar period, and must accept these restrictions as necessary in the process of world restoration, not as punitive measures against our products. The United States will be particularly affected by these measures, since it is possible that the whole range of consumers' durable goods, in which we excel, will be subject to restriction as items of secondary necessity. It

is also possible that much heavy industrial equipment will be bought elsewhere, also because of foreign exchange problems of both buyer and seller.

Of course, we should like to see American goods moving to all quarters of the globe. We should like to sell them wherever they are wanted and wherever they compete favorably with other products in terms of design, quality, and price. But we must realize that every country must protect its own foreign exchange position if it wishes to maintain exchange stability and be able to pay its bills owing to foreigners when they become due.

If we wish to speed up the time when our exports can move freely in the world's markets, there are a number of measures which will help us to obtain this desirable objective. First, we should get a high level of employment in the United States so that large imports of raw materials would be required which we would pay for with American dollars. Second, we should install long-term loans and make capital investments abroad so that essential productive machinery and equipment can be acquired. Third, we should reduce tariffs and remove the barriers to imports into the United States of the agricultural and manufactured goods of other countries. In the meantime, we should not press foreign countries to take American products which serve no sufficient useful purpose to them and which make excessive demands on their limited supply of foreign exchange.

The impulse to tariffs, quotas, and embargoes, and other devices to keep wanted goods from coming in across the borders does not spring exclusively from the

laudable desire to protect a currency from depreciation, or to allocate scarce foreign exchange to imported products which the country most needs. In fact, until after World War I, the two principal purposes of tariffs were (1) revenue and (2) the shielding of a domestic industry from foreign competition.

Here in the United States the need of tariffs for revenue purposes has long since passed. Some of our tariffs are so high that they produce no revenue at all. Some are applied to the elementary necessities of life, such as sugar, which, being in fact a sales tax on food, would be rejected out of hand if the true impact of the tariff were generally understood. In a country like the United States, which has no fear of the depreciation of its currency in world exchange and has other means of paying its bills, the tariff and associated protective devices in restraint of import trade are nothing more than means of raising prices to the consumer in our home market above the level that would prevail if the home market were free to all who want to sell to us.

The difference between the world competitive price of an article and the actual price caused by a tariff is therefore nothing more or less than a sales tax, a tax on home consumption. It is a sales tax that is paid by the consumer through the retailer, directly to the producer, without the intervention of any public agency.

This tariff-sales tax, paid by the consumer, provides a subsidy to particular industries. For this subsidy no accounting is required, and no specific performance.

The purpose of the tariff in keeping goods out of the country, and in increasing the price to consumers for

the goods which do come in, is to subsidize manufacturers who believe they could not make a satisfactory profit if the foreign goods were imported. To put it bluntly, in a free market without tariff protection, the preferences of the American consumer would shift to the foreign article because of its quality, design, or price. The American tariff tradition raises two questions of public policy which are as important to the consumer as they are to the producer: first, should some industries be subsidized, and, if so, which; and second, how should the expense of the subsidy be borne?

It is certainly true that we want to subsidize many of our industries. We want to preserve in this country the art and technical skill in doing many things which the people of other countries can do cheaper and better than we can do them today. We want to preserve these talents and to develop them, both for national defense and to have a well-rounded economy, with as great variety of productive opportunity as our natural ability and resources permit.

But we will never get value received in terms of true protection of an industrial or agricultural art, or in terms of the advancement of our national talents, through the use of these unregulated tariff subsidies financed by a blind sales tax.

This is not to say that for some products a tariff-sales tax may not be appropriate, assessing the cost of subsidizing the industry on the user of its products. But this method of sharing the cost should be examined in each particular case to make sure that direct subsidy from general revenues would not be cheaper and more

equitable. If we are going to continue to subsidize the science and art of sugar growing and refining, of wine production, and of the making of men's shirts, we should probably proceed by a different method than by the price-raising tariff-sales tax.

Not only is the present method of subsidy and cost-sharing inefficient and inequitable, but it is an important obstacle to the restoration of world order. Our import restrictions prevent the peoples of other nations from doing for us the things they can do better and cheaper than we can do them for ourselves; and, as a result, they cannot buy from us the things we can make better and cheaper than they themselves can make them. The net result is that our working force must carry an unnecessary burden of toil and sweat, and the peoples of other countries are deprived of the higher standard of living which the world's prevailing technology and art could make available.

Change from an indirect, unregulated tariff-sales tax subsidy to direct subsidy of needed industries cannot be made overnight. The present system has gone on for so long and is so deeply ingrained in our commercial and industrial life that it cannot be torn out with one pull. Vested interests of property and employment have gone into these sheltered industries in good faith, and if policy is to be changed, it should be changed in detail and with proper compensation for injury to capital and to labor.

What is needed is a change of direction and the taking of obvious first steps. Such a change would be acclaimed at home and abroad as a contribution of para-

mount importance to the peace and prosperity of the world. The example of the United States in moving toward a policy of discarding protective tariffs and toward forthright subsidies for the industries we want to subsidize in our own national interest would clear the air on the question of the true value of trade across the borders. If particular industries should be subsidized in the national interest, let them be subsidized; but, at the same time, let the movement of world commerce be free.

There is one type of protection a national state can give to its producers which increases rather than decreases the standard of living at home. Protection is necessary against arbitrary and irregular pricing by foreign producers. Episodic dumping, and short-range pricing on the basis of temporary expediency, political or economic, may be destructive to a particular industry with no net long-time gain to the nation. The propriety of such protection will be used to justify safeguards in circumstances where authentic competition presses with unwelcome severity, but we should not for that reason blind our eyes to the fact that the national state should protect its producers when to do so is in the long-run national interest.

4. Cartels

Cartels began when, for the first time, two traders decided to stop competing, to divide the market, to fix prices, and to exchange information. Cartels had their

first trouble when a third trader, an outsider, undersold them and got the business.

The word "cartel" is an elegant name for a simple idea. The idea is that there is more profit to be made in monopolizing a small market than in competing for a large one, or that it is desirable to make sure that the total production of an industry is controlled so that excess production will not force a break in prices and reduce the profits of the producers. Through the cartel, prices will be maintained and there will be profits for all, or nearly all; and such price concessions as are made can be reserved to make friends for the cartel.

The cartel idea is, therefore, neither in origin nor in application related exclusively to business international. Here in the United States the term is, to be sure, associated with world commerce because cartellike agreements, when they are arranged in interstate business, are illegal acts in restraint of trade. Naturally, these agreements are not matters of public information.

We must understand clearly that collusive agreements in restraint of trade, even though they may be illegal in the United States, are entirely legal and the order of the day in world commerce outside the United States between foreign countries and within many countries of the world. Business international in general regards the commercial policy of the United States under the Sherman Act, a policy favorable to competition and unfavorable to restraint of trade, as both unintelligible and unintelligent. Such a policy frequently prevents an "orderly" market and an assured profit. It permits "outsiders" to compete for the available business on the basis

of lower prices and better service to the consumer without giving too much attention to the so-called "long pull." Even the laws of the United States, as in the Webb-Pomerene Act, recognize that in international trade American companies may find it difficult to carry on their business unless they are permitted to conform in some measure to the practices of cartels and to the customs of foreign countries. But the special considerations afforded under the Webb-Pomerene Act have been little used and, under present conditions, the act has little practical effect.

The agreements made between companies in two or more countries concerning their methods of doing business are the foundation of international cartels. These cartels may exist in raw material production, manufacturing, or in any branch of commerce where it is desired to limit competition in a way favorable to the members of the cartel. Sometimes the limitations will come through agreements to restrict and divide production, as in the case of tin, or they may come through restraint on the introduction of new technical improvements, processes, or patents. The limitation to competition may occur by a division of markets, the producing companies of the world agreeing among themselves as to what countries they will stay out of and what countries they will take as their own.

In many instances—for example, in electrical manufacturing and in chemicals—an important aspect of the international cartel is the exchange of information on new products, processes, and patents. Information of this kind would ordinarily not be available for use through-

out the world until much later, if at all, unless the originating company was confident that its creative skill would not be used by others against it in competition. On the other hand, these agreements may injure the customer, since they create a situation whereby a new product may be suppressed for years if, by causing unwanted obsolescence of existing capital investment, it is harmful to the members of the cartel.

The international cartel is not always the smooth-running machine that a description of its methods and purposes might imply. The individual members of the cartel have their own interests to protect, and they have little loyalty to the cartel as such. After a certain length of time the strong members of a cartel become tired of supporting the weak, and the weak retaliate with whatever weapons come to hand. The exchange of information is fine in theory, but in practice many secret processes may be withheld, as has been dramatically shown by the German members of the chemical cartel. Then, too, there is always the problem of "outsiders," companies which refuse to come into the cartel in the first place or which develop their businesses outside the cartel and grow strong enough to become annoying competition to the cartel.

The international cartel is an association of national private business governments, and, to the extent that the cartel makes rules and enforces them, it is itself an international private government. The agreements between the companies are treaties binding them together. The cartel, an international private government, thus finds itself with no international public government to

which it can look for authority, protection, or regulation.

Although each national company is subject to the laws of its own nation, the cartel itself, in its actions, may not be subject to the laws of nations affected by its decisions. For example, the division of markets throughout the world outside the United States for exclusive exploitation by particular members of a cartel is not subject to public regulation. If American drug companies agree within the cartel that they will not sell in Argentina, there is no power in Argentina which can compel them to do so.

The absence of any public international authority empowered to regulate cartels, and the injection of the national state into the picture to protect the alleged interests of its private national companies in private international agreements in restraint of trade, produces confusion and conflict at the level of international public order. The regulation of business international by international public agencies will someday be an element in the world organization for peace. Such regulation will not be easy to arrange or to administer, but until the rule-making and rule-enforcement of the cartel—an international private government—is brought under the jurisdiction of international public law, there will be a constant threat to all who are governed by its decisions, a threat to public order and to freedom.

3

FISCAL POLICY AND PRIVATE BUSINESS

VIII

Profits and Purchasing Power

1. Health in Business

A SICK business serves the cause of freedom badly. In a sick business, stockholders, employees, vendors, and customers, all are governed by rule-makers whose objective is survival and whose motivation is fear. In such a business there is no "long pull," and short-run policies dictate the decisions of the manager. The sick business has no freedom and it can give no freedom. It can be victimized in every business transaction, and it protects itself as best it can.

There are many kinds of sickness in business. Some of these sicknesses affect particular businesses, and some, like an epidemic, affect business generally at about the same time. The two most common and dangerous epidemic diseases of business are paranoia and pernicious anemia. Paranoia is a psychotic condition in which delusions of persecution evolve into delusions of grandeur. Frequently the two forms of delusion alternate, and it is hard to tell which is the cause of which. In any case, paranoia is characterized by an essential dissociation

from reality. Treatment is uncertain and prognosis is obscure. In the individual, paranoia is considered incurable. Whether epidemic paranoia in business will yield to the will to live and the passage of time remains to be seen.

Unlike paranoia, the epidemic anemia of business can be cured by adequate nourishment, fresh air, and vigorous exercise. There are some who believe that the paranoia of business was caused by the anemia, and that, once normal conditions are restored, the psychotic disturbances will pass away. Others have doubts. But, in any case, there can be no question that for the individual person adequate nourishment is a favorable foundation for a sound mind, or that thriving business is a necessary prerequisite to sound business statesmanship.

The undernourishment of business comes from insufficient profits and prospects of profits. When this condition applies only to a particular business, we can regretfully charge the disorder to the requirements of survival in a competitive universe. But when business generally is undernourished for lack of profits, we must look to the environment generally. The presumption is that the environment is not favorable to business survival.

An environment unfavorable to business survival may result from two causes: first, from public repudiation of the policies of private business government; second, from the absence of a sufficient flow of purchasing demand to keep the wheels of business turning. The first of these causes results in revolution, the second in depression. In the United States we have so far suffered

only from the second cause, depression. There is, with us, no substantial desire that some new way, other than private business, should be found to get ready for use the things that the people want and need.

But sick business serves the cause of freedom badly, and people are more interested in freedom than they are in business. Accordingly, our American disorder of business depression must be cured if private business is to survive. An adequate flow of purchasing demand must be maintained as a necessary condition for business health, and business health is necessary if we expect private business government to be effective as an instrument for human freedom.

2. *Profits from Transactions*

Our interest in freedom, and in the part that private business government plays in the attainment of freedom, therefore, requires that we be concerned with business health and with the conditions that favor business health. And, as we have seen, business health is nourished by business profits.

In an earlier chapter we have seen the way profits act as a directive energizer for the individual business, getting the things produced that people want and imposing pressure for efficiency in the use of human effort and materials. Now, as we consider profits for business as a whole, we come to a new set of problems, problems

which relate to the adequacy of purchasing demand as a whole. These problems center in the nature of purchasing power and of its movement in the national community, since it is only through the flow of purchasing power that the nourishment of business by business profits can be accomplished.

A business can be rich and still be sick—profitless. So also, business as a whole can be rich and still be unhealthy. The balance sheet of business may show enormous assets and modest liabilities, and still it may not be doing the work that it is the business of business to do. The activities of business consist of business transactions, not of assets and liabilities on a balance sheet. The balance sheet is only a cross section at a moment of time, showing how, at that moment, the business stands; what, at that moment, the business has to work with. The work itself consists of the business transactions that preceded and will follow the balance sheet cross-section picture.

If there are no transactions, there will be no profits. If there are insufficient transactions, there will be insufficient profits. Large numbers of transactions do not, of course, guarantee profits, but they are a necessary first condition in providing a situation in which profits can be made.

In a business transaction, the transaction is always associated with the transfer of purchasing power. Usually this purchasing power is lawful money, or an equivalent expressed in lawful money. Sometimes, to be sure, business transactions are direct exchanges of property or services—barter arrangements—but barter is the exception in a money economy such as ours.

Since business transactions ordinarily are associated with the transfer of money purchasing power, the aggregate value of the transactions will depend on two things; first, how much of this purchasing power is outstanding; second, how rapidly it flows, how frequently it passes from hand to hand. The problem of purchasing demand is, therefore, a problem in two dimensions, the quantity of purchasing power and its rate of flow in time.

3. Power in Motion

Purchasing demand is purchasing power in motion. It is dollars of circulating medium circulating. The level of purchasing demand depends on how much purchasing power is moving, and how fast. Most of the job-creating stream of purchasing demand arises from the day-to-day needs of a hundred million people and millions of businesses, carrying on their private economic lives with the purchasing power at their disposal. At times, this stream of purchasing demand is augmented by the lending activities of tens of thousands of commercial banks, savings banks, and insurance companies. Sometimes this increase occurs because these financial institutions have taken slow-moving purchasing power, represented by the savings of individuals, and have speeded it up by making it available to business. Sometimes, by their transactions, they actually increase the amount of purchasing power in the stream.

The sum total of all these private transactions

creates a mighty river of purchasing demand which rises and falls as a result of a hundred million private, free decisions. These acts are based on the particular circumstances as they appear in the moment of decision to him who has the power to spend, to invest, or to wait. In their private dealings, these individuals have no public responsibility for trying to increase or to decrease the general stream of demand. In attending efficiently to their own business, they do their own part.

Although the adequacy of the stream of purchasing demand affects the welfare of each individual, there is nothing, as individuals, that they can do about it. But, by working together through their government, they can weaken or strengthen the flow to compensate for the aggregate decisions of private enterprise as a whole. In this way they can increase the stream if it falls too low, and they can hold it in check if it rises toward an inflationary flood.

The regulation of the flow of purchasing power, the control of the level of purchasing demand, and at the same time, the preservation of the freedom of the individual to spend, save, or invest his money as he pleases, has become the central economic problem of democratic governments in the safeguarding of human liberty.

4. *The Private Banks*

The banking system adds to the stream of purchasing power when it makes a loan, and it takes away from

the stream when a loan is repaid. The banking system responds to the body economic with the varied decisions of tens of thousands of separate banks, all working within a common basic tradition and within the framework of governmental rules as sanctioned by law. One loan is made, another is refused; a loan is refused by one bank, and it is made by another. Sometimes loans are hard to make, and the rate of interest is high. Sometimes, when the rate of interest is high, loans are easy to make; sometimes, when the rate of interest is low, borrowing from the banks is difficult indeed. The banking system is many and it is one. Because of banking tradition and because of public law and regulation, there is in banking policy a definite predictability and a definite tendency. Yet, for the borrower, there is always a certain range of choice as between particular banks; and every bank knows that its good customers would be welcomed by its competitors.

The banking system, being tens of thousands of separate and autonomous banks, responds variously to the needs of hundreds of thousands of separate businesses. The needs of businesses for the purchasing power created by the banking system arise in the ordinary processes of production and distribution. Money must be spent for raw materials, for labor, for freight, for advertising—all in advance of the final sale to the final customer. In the meantime, as goods move from producer to wholesaler and from wholesaler to retailer, the banking system stands by, ready to pump out the purchasing power—to make the loans that will enable the producer or distributor to pay his bills, if he hasn't money enough of his own to take care of them. When the final payment

is made out of the pocket of the consumer, the loans made by the banking system are paid off; and, in this way, the purchasing power that has been pumped out is drawn back in again.

The loan made to a business by a bank is made on the initiative of the business, and at the bank's discretion; but there are several points where national and state governmental bodies come in to make sure that the stream of purchasing power put out by the banks has a healthy flow. Bank examinations, deposit insurance, limitations on loans—on securities and for consumer credit—all affect the general operating policies of the banks. Then, too, the Federal Reserve System has its special powers to adapt the supply and the cost of credit to the needs of the business community, as they are reflected through the banks.

The banking system and the myriad businesses working with it—each and all of them—are making separate and independent decisions based on their separate and independent judgments of what a particular business needs. But the needs of business as a whole for an adequate flow of purchasing power are not the same as the needs of individual businesses for the specific purchasing power required by them in order to pay their bills. It is true that the money which businesses borrow from the banks gets into the stream of purchasing power and stays there until the loans are paid off, but the rate of flow of the stream—the pulse—may not be rapid enough to absorb the high production of industry that would come with high employment of men and machines and factories. Or the pulse may be too rapid, displaying a

feverish demand that would overburden the capacity of business and would result in excessive labor requirements and, soon after, in an inflationary rise in prices.

Government can influence the banking system by regulatory methods, particularly by those which we include within the area of monetary policy. Government can manage its tax and expenditure budget in terms of explicit and internally consistent fiscal policies. It is obvious that fiscal policies and monetary policies should be associated in an over-all conception of the relation of fiscal and monetary policies to private business activities, to the demands of high production and high employment.

5. *Intervention*

Why should it be necessary for the government to intervene to make sure that purchasing demand is present in sufficient amounts to give us a healthy business condition? Why isn't this something that the banks can handle, working alone? There are two reasons why such intervention is needed: first, to meet seasonal, episodic, and long-time ups and downs of business activity; second, to meet a persistent tendency of purchasing power to come to rest.

The seasonal and episodic ups and downs in the requirements of business for purchasing power in the form of loans have resulted in the establishment of the Federal

Reserve System and in the modifications of the System after the banking crisis of 1933. Before the System was created, the country suffered periodical disturbances due to the inability of the banks to provide for the needs of business out of their ordinary resources. Occasionally, during such a crisis, the withdrawal of deposits would add fuel to the fire, and a conspicuous bank failure might even touch off panic conditions. The normal processes of production and distribution would be deeply affected, and needless unemployment and losses of homes, farms, and businesses would result, not from operating losses, but from an inability to meet the maturities of loans or to find ways of refunding them. In 1933, the crisis became so acute that thousands of banks which later were proved to be entirely solvent were embarrassed by the wave of demand by their depositors to claim deposits.

Corrective measures have now been taken: first, to make sure that solvent banks will be able to go to one of the twelve Federal Reserve banks and get money lent to them on the loans and investments they themselves have made; second, to make sure that homeowners, farmers, and businessmen can meet the maturity of loans by getting new loans if they are needed; and third, to make sure that the depositors of an insured bank can always get out their deposits in cash, up to at least $5,000.

These corrective measures are administered by the government, and they protect the country against many acute situations which have been so disastrous in our history. To a limited extent, these measures of banking and monetary regulation also help us deal with the longer-time ups and downs which we have come to call the

"business cycles." But, helpful as these measures are, they are not enough to restore business activity if a real slump occurs. It is now generally recognized that the national budget must be called on to support purchasing power on the down side of a business cycle. The national budget could be used to hold a boom in check, but since immediately after World War I we have not seen a peace-time employment boom—only real estate and stock market booms, which are, at best, indirect and uncertain stimulants to employment.

These ups and downs of business activity—seasonal, episodic, and cyclical—could probably be compensated for by monetary and budget policy to a considerable degree, and without too much trouble, if it were not for another difficulty about purchasing power. This difficulty arises from the fact that purchasing power tends to cool off, to come to rest. This tendency results from the inevitable passage of purchasing power from the hands of the economically weak, from people who must spend all they receive, into the hands of the strong, to people who may retain some portion of it, however small, for longer or shorter periods of time. The quantity of purchasing power, the amount of circulating medium—bank deposits, currency, and coin—existing at a certain point of time, will *tend* to diminish as effective purchasing demand in the day, or month, or year following. It will tend to diminish as a consequence of the internal necessities of its movement from weak hands to strong.

This tendency has been obscured by counterinfluences, such as, for example, of banks to lend, of entrepreneurs to borrow, of the rate of commercial turnover

at times to increase, of kings to clip coins, of gold to be discovered, of thieves to steal, of bankruptcies and panics to dissipate assets, of unemployment to force the spending of savings, of foreign loans and foreign conquest to reverse for a time the inevitable slackening of demand. Underneath all these superficial and temporary excitations, the rate of movement of purchasing power persistently falls.

To maintain a level of purchasing demand over the years, either the quantity of circulating medium must be constantly increased, or the natural flow of purchasing power from the weak to the strong must be countered by an equivalent flow from strong to weak, or there must be a combination of the two.

Unless purchasing demand is maintained, prices will fall, debtors will lose their farms and homes, unemployment and miserable poverty will be the lot of millions, and a few will find that compound interest and falling prices have miraculously augmented their command over all the things that money can buy. "The strong grow stronger and the weak grow weaker." Soon the economic problem becomes a social and political problem, and the unstable equilibrium must be supported by force or it will be destroyed by revolution.

We want to leave private business and private banking free to follow their independent business judgments as to the profitability of particular business transactions. At the same time, adequate over-all purchasing demand must be maintained. If we are to have both freedom of private enterprise and an adequate purchasing demand, we must use fiscal and monetary policy to compensate for

the major changes in the level of private business activity. We must also use fiscal and monetary measures to offset the normal persistent tendency of purchasing power to come to rest.

It was once generally believed that the flow of purchasing power would be best protected by allowing changes in the price level to restore the balance between purchasing demand and our capacity to produce. Thus, if purchasing demand fell off, the level of prices was supposed to fall off too, so that at the new price level the full output of our productive capacity would be used to make the things that people need. Under this theory, the national budget should always be in balance so that no influence other than supply and demand would determine the level of prices at which high productivity would occur.

This theory had two difficulties. First, it meant that we had to have mass unemployment until savings had been exhausted and wages driven to a subsistence level; second, it meant that we had to expect wholesale insolvency in order to squeeze the marginal equities in farms, homes, and businesses out of the national balance sheet —that is, to destroy the savings of tens of millions of citizens. Bondholders, professors, government employees, and landlords, all whose income had been fixed by contract, were made able to serve the nation by consuming more of the national product than their original contract intended.

Today the theory of a balanced budget to maintain high production and high employment by deflation of prices and wages is almost everywhere rejected. A log-

ical case can be made to show that, if wages were forced low enough and bankruptcy general enough, the purchasing power remaining with the strong would be enough to command the labor of all. However, it is improbable that we shall redistribute wealth and income that way. It is more likely that we shall attempt to use the national budget to maintain purchasing demand as the more conservative and less dangerous alternative, recognizing that our first efforts will be experimental, clumsy, and imperfect.

Efforts to use the national budget as a means of maintaining purchasing demand will not be entirely successful unless, at the same time, we succeed in getting the savings of the people invested in new private enterprise. Fiscal and monetary policy alone cannot accomplish full investment of savings. Government stability; satisfactory cost-price relationships; the outlook generally for business volume and profits; clarity and simplicity in laws and regulations; protection against illegal aggression; access to markets, to labor, to processes, to raw materials; the terms on which loan and equity capital is available—these and other considerations determine in detail whether or not an investment will be made. But fiscal and monetary policy can aid strongly in achieving a healthy condition in private business by sustaining an adequate level of effective demand.

IX

Fiscal Policy: Tools and Objectives

1. The Budget

LET us retrace the logic that compels us to look to fiscal policy as a necessary element in our search for freedom. We have recognized that private business government, in its rule-making, provides the frame of order and certainty for a significant portion of our important everyday decisions. We have recognized that only when business is healthy can this rule-making be expected to result in a healthy frame of order. And we have seen that healthy business requires an adequate volume of business transactions, transactions which can occur only in response to an equally adequate effective purchasing demand. The maintenance of adequate effective demand is thus indispensable if we are to look to private business as an instrument for freedom. Choice of employment, choice of markets, choice of investment, choice of the goods and services we want to use—all depend on a high and sustained level of business activity.

The maintenance of a high sustained level of business activity is conditioned absolutely on fiscal policy. A sound fiscal policy will not, of itself, produce a satisfac-

tory level of business activity, but an unsound policy will destroy the possibility of its attainment. And so, for this reason, we must examine fiscal policy in some detail.

Fiscal policy is expressed through the financial budget of the national state. Among other things, the national budget should reflect a unified policy of government with respect to the activity needs of business and of the nation as a whole. Being the instrument of a single government, it is possible for the budget to show, in this respect, singleness of purpose and internal coherence. Indeed, it will, of necessity, show purpose and coherence if the government itself knows the level of activity that is needed, and how it intends to get there. But, if the government is divided against itself, its fiscal policy, expressed in the budget, will reveal this internal conflict. If the government is confused, its fiscal policy will be confused and capricious.

The national budget can be so arranged, as a unity, to complement and to supplement the aggregate activities of business in the maintenance of adequate effective demand. A national government adds to the stream of purchasing power when it lends or spends money, and it takes away from the stream when it borrows from private individuals or when it collects a tax. The fiscal policy of the government, therefore, has a decisive effect upon the level of demand, both by influencing the quantity of purchasing power available and by causing changes in its rate of flow—upon the rate at which purchasing power becomes purchasing demand. Accordingly, national fiscal policy, through the budget, can be used to contribute

importantly to the general adequacy of purchasing demand needed for a healthy business system.

But, before we can proceed further, we must make clear what is here meant by the term "federal budget." For purposes of policy consideration, we must take the federal budget to include all the financial transactions of the federal government, whether they fall under the jurisdiction of the Bureau of the Budget or not. The federal budget would include social security and other trust accounts, and the several federal corporations and lending agencies. We must take this inclusive view because, since the federal government has the power to associate the totality of its financial transactions in a single schema, judging one item against another item and each item against the whole, the federal government may have a policy with respect to this comprehensive budget.

Let us see how the budget can be used to bring about (1) changes in the quantity of purchasing power available and (2) changes in the rate of flow of purchasing power. The quantity of purchasing power is affected by whether the budget shows a deficit or a surplus, by how the deficit is financed, and by what disposition is made of the surplus. In general, if there is a deficit, the quantity of purchasing power in the hands of the public is increased; and if there is a surplus, the quantity is reduced. The method of financing the deficit must be taken into account in judging the effect of the deficit in creating purchasing power in the hands of the public. If the deficit is financed by loans from commercial banks or from the Federal Reserve banks, purchasing power will

be increased. But if the borrowing comes in the form of the sale of governmtnt bonds to private investors, the federal deficit will take away from purchasing power in the hands of the public an amount equal to the quantity that the deficit has created. A surplus in the budget will take away from purchasing power if the surplus is used to retire government debt held by commercial banks or by the Federal Reserve banks; but, if it is used to retire government debt held by the public, the retirement of this kind of debt adds as much purchasing power to the amount in the hands of the public as the creation of a surplus in the budget had taken away.

The rate of flow of purchasing power is affected by the character of the taxation, expenditure, and borrowing program. Some taxes have a greater impact on the rate of flow than other taxes; and there are differences among expenditures, too, in their influence on the speed with which purchasing power flows from hand to hand. Sales taxes and excise taxes reduce the rate of flow drastically, since these taxes are taken from the purchasing power of the great body of citizens who otherwise would have spent most of them for things they need. Corporation taxes, in keeping prices up and wages down, and limiting the return on new investment, are a heavy load for purchasing power to carry. The progressive income tax has a lesser influence on demand, although, if the rates of taxation on income are too high, there will be little inducement for risk-taking investment in private business; and this, in itself, will have an unfavorable effect on the level of purchasing demand. The estate tax has the least effect of all taxes on the rate of flow of pur-

chasing power, since the amounts collected in this way probably would have remained invested and would not have been spent by those who are the beneficiaries of the estate.

On the expenditure side, those disbursements which are quickly and fully spent by the people who receive them, or which become the foundation for a much larger expansion of credit, are the most effective in stepping up the rate of movement of purchasing power. Some expenditures, if they are too unconventional or if they affect unfavorably the outlook for private risk-taking, will weaken—because of the impaired confidence—the stream indirectly by more than they can add to it directly. The administration of the national budget does not occur in an arithmetical vacuum.

One item on the expenditure side of the budget is likely to prove troublesome for postwar fiscal policy. This item is "interest on the public debt." Current estimates indicate that, after the war, interest on the public debt may amount to as much as five or six billion dollars—nearly a third of the ordinary federal budget. When we examine the use that is likely to be made of the interest on the national debt by those who receive it, we find that these large sums will go in substantial amounts to recipients not likely to spend or to invest them promptly. As a result, if this expenditure is covered by taxation, it is likely that the total effect will be to lower the average rate at which available purchasing power is turned into purchasing demand. One of the great problems of postwar fiscal policy will be so to manage the national debt that interest payments and amortization do

not have a depressing influence on the level of business activity.

Both the direct and the indirect consequences of taxation and expenditure must be appraised in relation to what the maintenance of the stream of purchasing demand seems to require. Such appraisal cannot be made with precision, but it is not too difficult to estimate general tendencies and gross quantities. As a matter of common knowledge, for example, the national budget for the fiscal year 1938 was sharply deflationary in comparison with that of fiscal 1937.

The methods of taxation and expenditure which have been mentioned illustrate how the national budget can be used to influence the level of purchasing demand. The budget can be used either to affect the quantity of purchasing power in the hands of the public or to influence the rate of its flow, or it can be used to do both in varying proportions. But, to do these things, we must have a national government that is understanding and responsible, that is organized and equipped for a new kind of human undertaking. National fiscal policy and progress in the postwar world must be devised, approved, and carried out in ways that will interrupt the blind forces of atomistic private economic activity. These national fiscal policies and programs must seek deliberately to reverse the tendency of purchasing power to come to rest, they must intervene to maintain purchasing power in motion on a high and stable level, and they must ensure an effective demand for the goods and services that the labor and resources of the country stand ready to produce.

2. *First Things First*

Much as we want a fiscal policy that will help us to get and hold a high level of prosperity, much as we want high production and high employment, we do not want a fiscal policy that would depreciate the value of the dollar. We do not want any funny money, rubber checks, or trillion-mark notes. We want a sound currency, a stable dollar, a unit of value that we can count on, money that will be worth tomorrow what it is today—a medium of exchange that we can put our savings in, make contracts and leases in, do business in. We want to be sure that our money is good, that we can buy things with it at something like today's prices, today, tomorrow, and in the years to come. We also want an efficient system of financial institutions through which money transfers can be made, in which money balances can be safely stored, and by which loans and advances to businesses and to individuals can be promptly and justly arranged.

Two objectives of fiscal policy come first: the maintenance of a reliable currency and an efficient system of financial institutions. A fiscal policy directed toward the maintaining of an adequate level of purchasing demand must, in any case, hold firm these two basic purposes.

One of the two primary objectives of fiscal policy is to keep the value of the dollar stable. How can this be done? We all know that we can no longer turn our money into gold. We wonder, sometimes, what makes our

money good. Look at a twenty-dollar bill, a Federal Reserve note. What does it say on it? "The United States of America will pay to the bearer on demand twenty dollars." What are these twenty dollars? Twenty dollars is what the United States of America will pay on demand to the bearer of a twenty-dollar bill. This does not get us far.

Printed in small type on the twenty-dollar bill is other language, other significant language, as follows: "This note is legal tender for all debts, public and private . . ." In other words, as long as there are debts, bonds, money obligations of any kind, these notes can be used to pay them off. Furthermore, as long as there are taxes, import duties, fines, and other payments due the government, these notes can be used to discharge them. In an essential and final sense, the value of the notes lies, not in their convertibility into gold and other commodities, but in the fact that they can be used to discharge obligations which are enforceable under the law. Any person who holds these Federal Reserve notes in amounts equal to his debts may give them to his public and private creditors and be freed of any further obligations for payment.

As long as the money of the United States can be used to pay off debts and taxes, and as long as there are any debts and taxes that must be paid, the money of the United States will have a certain value. Money needs only to be "legal tender for the payment of debts, public and private" to make it sought after by all who must pay taxes or who owe a debt.

The fact that paper dollars are legal tender gives

them a certain value; what this value will be depends on how scarce or how plentiful these dollars in use for the purchasing of things are as compared with the quantity of goods and services offered for sale. Or, to put it another way, apart from paying debts and taxes, the dollar is worth what it can buy in the market. If the dollar can command much the same amount of goods and services day after day and year after year, the dollar will not only have a value—it will have a stable value.

In order to achieve this stability, the stream of purchasing demand must be kept in line with the stream of available goods. To keep a stable dollar, the budget must be planned to stabilize the stream of purchasing demand, to compensate for the ups and downs of private enterprise in creating a demand for the things we are able to make. The necessity for a stable dollar requires that the expenditure program of the federal government and the tax program must be closely associated. The necessity for a stable dollar means that, if we are going to spend greatly, we must tax greatly. It does not mean that we must necessarily balance the national budget. What it does require is that the effect of the expenditure and the tax programs, taken together, on the stream of purchasing demand, should be such as to give a fair balance between purchasing demand and the available supply of goods and services. The stable dollar is to be found, not in the convertibility of the currency into gold and silver in a balanced budget, but in an adequate flow of purchasing demand which will absorb the goods a constantly increasing level of productivity can make available.

Competition and technological improvements will bring a wholesome pressure to lower costs and, correspondingly, to lower prices. From an over-all point of view, these changes will be gradual. Lower prices as a result of efficiency are desirable, since they increase the real income of the people, but they do not, fortunately, increase the value of the dollar because of the deflationary pressures associated with an insufficient effective demand.

The second of the basic objectives of fiscal policy is the maintenance of an efficient system of financial institutions. The achievement of this objective has been found to require a considerable amount of regulation of private banking by governmental bodies. In administering this regulation we want to preserve competition in private banking. We want this competition not only to improve the services of the banks, but also to give to the borrower alternative sources of credit. The granting of credit is not an automatic matter of attaching an interest rate to a risk, but there is wide scope for intuition and ingenuity in the making of loans adapted to a borrower's needs. In preserving competition in the banking system, we must at the same time protect the resources of the depositors and give to the banking system flexibility to meet seasonable and episodic requirements, both for loans and for withdrawals. The present regulation of banks aims to preserve competition with safety.

The thought is sometimes expressed that we could reach our fiscal and monetary objectives more easily if the banking system were taken over by the government and nationalized. The feeling seems to be that, with com-

plete control of the financial system, we could more easily make our money system work the way we want it to. In my opinion, this feeling is unjustified. When sincere, it probably springs from an idea that the banking system itself ought to be able to keep the stream of purchasing demand at the right level. As we have seen, this job is not one of which the banking system is capable. Maintaining purchasing demand is the job of national fiscal policy, operating through the budget and with the cooperation of the regulatory agencies. It will continue to be a problem of national budget administration, no matter who owns the banks. And if the banks should be nationalized, we would lose the competitive flexibility in costs and in credit judgment that alone can give the clue to the true economic situation within which national fiscal policy must work.

It is true that the banking system must be associated co-operatively with the national fiscal policy. This cooperative association is expressed through several national agencies, the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency, of which the Reserve System is the most important. These agencies set the broad framework of the banking pattern, and it is helpful when it can be set so as to support a national policy in which fiscal and monetary objectives are widely co-ordinated. This has not been possible in recent peacetime years because there has been no co-ordinated national policy in the fiscal and monetary field.

X

Business Is Taxed

1. Fiscal Policy, Taxation, and Public Works

NATIONAL fiscal policy, so important to business health, is administered principally through the federal budget. In appraising the economic consequences of the budget as an aggregate, fiscal policy must take into account the significance of every particular item, because every item of the budget—every receipt and every disbursement—has some effect, large or small, on the flow of purchasing power. The items of the budget must, therefore, be judged from two points of view: first, from the point of view of public policy; and second, from the point of view of fiscal policy. Public policy is concerned with the objective which a budget item is directed to accomplish, and fiscal policy is interested in the financial and economic impact of the budget item on the level of demand. Although the public policy reflected in the character of budget items is necessarily the paramount consideration in deciding what should or should not be approved, considerations of public policy can never be divorced from the concurrent fiscal effect of the execution of that policy on the economic welfare of the nation.

Although every item of the budget, both disbursements and receipts, has its particular importance for fiscal policy, there are two classes of items of particular interest to business. These items are: (1) those concerned with taxation; and (2) those providing for public works. Not only do these items loom large in the administration of a sound fiscal policy, but they also affect directly the character of business operations which can and will be undertaken.

The taxation of business obviously enters into every business judgment. The importance of public works may not be so obvious. The reason is that public works can be so organized and administered as to help stabilize the construction industry. Such stabilization would give great benefits to this important industry directly, and indirectly to all business through the reduction of costs in construction. Reduction of costs may be confidently expected after the construction industry is freed of the expense of idle men, idle plant, and idle capital which historic irregularity of production in construction has imposed upon the industry.

For these reasons, we shall discuss in some detail, in this chapter and the next, the subject of taxation, with particular reference to the taxation of business; and the subject of public works, with particular reference to the possible relations between public works and the construction industry. We shall pass over other aspects of fiscal policy, important as they are for a comprehensive picture of that subject, as having less immediate bearing on the character of the rule-making of private business.

2. *Tribute*

The superior position of public government over private business is nowhere more clearly evident than in government's power to tax business. Business as private government gets its many rule-making powers from public government. Public government sets the limits to the exercise of these rule-making powers of business, and protects the freedom of business operations within this area of authority. Public government can limit business, but business cannot legally limit public government except by invoking public law. Taxation is one of the limitations placed by government on the power of business to do what it pleases.

Some taxes are nothing more than methods of sharing the cost of a common benefit. Illustrations of such common benefits are: police and fire protection, the assurance of a healthful and abundant water supply, the maintenance of good roads and clean streets, and the regulation of business monopoly. All taxes have something of the justification of shared benefit in them in the sense that public funds wisely spent improve the well-being of the people and safeguard them from enemies at home and abroad.

But these shared benefits are often of a general character and extremely indirect, and business is given little to say as to what it wants and how much it is prepared to pay. To be sure, business may express its views on tax-

ation before various committees and in the press; however, the fact remains that the business which is taxed does not vote, nor is it represented as business in the legislative halls at the time a tax is levied.

Taxes on business, particularly on business income, are a tribute paid by one rule-maker to its superior as the price of its subordinate authority. The price is imposed, not negotiated; and private business must do the best it can with its delegated powers in order to make good.

There is nothing reprehensible about this procedure. The business that is taxed is not a creature of flesh and blood, it is not a citizen. It has no voice in how it shall be governed—nor should it. The issues in the taxation of business are not moral issues, but are questions of practical effect: What will get the best results? How should business be taxed so that business will make its greatest contribution to the common good?

3 *Why Tax?*

If we are to understand the problems involved in the taxation of business, we must first ask the question, "Why does the government need to tax at all?" This seems to be a simple question, but, as is the case with simple questions, the obvious answer is likely to be a superficial one. The obvious answer is, of course, that taxes provide the revenue needed by the government in order to pay its bills.

If we look at the financial history of the past ten years it is apparent that nations have been able to pay their bills even though their tax revenues fell short of expenses. Those countries whose expenses were greater than their receipts from taxes paid their bills by borrowing the necessary money.* The borrowing of money, therefore, is an alternative which governments use to supplement the revenues from taxation in order to obtain the necessary means for the payment of their bills.

To be sure, the borrowings of a country must be paid in money at some future date when the loans fall due, and, in the meantime, interest must be paid on the principal of the loan. Since, when a government borrows, it must provide the money for both principal and interest, its need for taxes seems greater than ever—the only difference being that the time of taxation is postponed.

However, when these loans fall due, the government may decide to borrow again and, with the proceeds of the new loan, pay off the principal of the old. Such a refunding operation again provides the money which the government needs—and, again, the need for present taxes is avoided.

A government which depends on loans and on the refunding of its loans to get the money it requires for its operations is, necessarily, dependent on the sources from which the money can be obtained. In the past, if a government persisted in borrowing heavily to cover its expenditures, interest rates would get higher and higher

* Sometimes these governments borrowed from the people in foreign countries and when they did, they generally got into trouble. Sometimes these governments borrowed from sources at home. When they borrowed at home, everything seemed to go along smoothly.

—and greater and greater inducements would have to be offered by the government to the lenders. As a consequence, power over the government would gradually shift, in some measure, to the money market, and it could dictate the terms on which the necessary loans would be made. Governments then found that the only way they could maintain their sovereign independence and their solvency without resorting to the printing press was to tax heavily enough to meet a substantial part of their financial needs, and to be prepared—if placed under undue pressure—to tax to meet them all.

The necessity for a government to tax in order to maintain both its independence and its solvency still holds true for state and local governments, but it is no longer true for the national government. Two changes of the greatest consequence have occurred in the last twenty-five years which have completely altered the position of the national state with respect to the financing of its current requirements. The first of these changes is the gaining of vast new experience in the management of central banks. The second change is the elimination, for domestic purposes, of the convertibility of the currency into gold or any other commodity. No longer do private lenders have the final word on the fiscal policies of a national government which does not tax.

The unsound practices of a reckless, taxless government can be controlled by the citizens of a democratic country; but they must exercise this control as citizens, and not as lenders. This final freedom from the imposition of unwanted control by the private lenders holds true for every sovereign national state where there

exists an institution which functions in the manner of a modern central bank, and whose currency is not convertible into gold or into some other commodity.

The United States is a national state which has a central banking system, the Federal Reserve System, and whose currency, for domestic purposes, is not convertible into gold. It follows that our federal government has final freedom from the money market in meeting its financial requirements. Accordingly, the inevitable social and economic consequences of any and all taxes become the prime consideration in the imposition of taxes. In general, it may be said that since all taxes have consequences of a social and economic character, the government should look to these consequences in formulating its tax policy. All federal taxes must meet the test of public policy and practical effect. The public purpose that is served should never be obscured in a tax program under the mask of raising revenue.

Federal taxes can be made to serve four principal purposes of a social and economic character. These purposes are:

1. As an instrument of fiscal policy to help stabilize the purchasing power of the dollar.
2. To express public policy in the distribution of wealth and of income, as in the case of the progressive income and estate taxes.
3. To express public policy in subsidizing or in penalizing various industries and economic groups.
4. To isolate and assess directly the costs of certain national benefits, such as highways and social security.

In the recent past, we have used our federal tax program consciously for each of these purposes. In serving these purposes, the tax program is a means to and end. The purposes themselves are matters of basic national policy which should be established, in the first instance, independently of any national tax program.

Among the policy questions with which we have to deal are these: Do we want a dollar with reasonably stable purchasing power over the years? Do we want greater equality of wealth and of income than would result from economic forces working alone? Do we want to subsidize certain industries and certain economic groups? Do we want the beneficiaries of certain federal activities to be aware of what they cost? These questions are not tax questions, they are questions as to the kind of country we want and the kind of life we want to lead. The tax program should be a means to an agreed end. The tax program should be devised as an instrument, and it should be judged by how well it serves its purpose.

By all odds, the most important single purpose to be served by the imposition of federal taxes is the maintenance of a dollar that has stable purchasing power over the years. Sometimes this purpose is stated as "the avoidance of inflation"; and without the use of federal taxation, all other means of stabilization, such as monetary policy and price controls and subsidies, are unavailing. All other means, in any case, must be integrated with federal tax policy if we are to have tomorrow a dollar that has a value near to what it has today.

The war has taught the government, and the government has taught the people, that federal taxation has

much to do with inflation and deflation, with the prices which have to be paid for the things bought and sold. If federal taxes are insufficient or of the wrong kind, the purchasing demands of the public are likely to be greater than the output of goods and services with which this purchasing demand can be satisfied. If the demand becomes too great, the result will be a rise in prices, and there will be no proportionate increase in the quantity of things for sale. This will mean that the dollar is worth less than it was before—that is inflation. On the other hand, if federal taxes are too heavy or are of the wrong kind, effective purchasing power in the hands of the public will be insufficient to take from the producers of goods and services all the things these producers would like to make. This will mean widespread unemployment.

The dollars the government spends become purchasing power in the hands of the people who have received it. The dollars the government takes by taxes cannot be spent by the people, and, therefore, these dollars can no longer be used to acquire the things which are available for sale. Taxation is, therefore, an instrument of the first importance in the administration of any fiscal policy.

The second principal purpose of federal taxes is to attain more equality of wealth and of income than would result from economic forces working alone. The taxes effective for this purpose are the progressive individual income tax, the progressive estate tax, and the gift tax. What these taxes should be depends on public policy regarding the distribution of wealth and of income. It is important, here, to note that the estate and gift taxes have

little or no significance, as tax measures, for stabilizing the value of the dollar. Their purpose is the social purpose of preventing what otherwise would be high concentration of wealth and income at a few points, as a result of investment and reinvestment of income not expended in meeting day-to-day consumption requirements. These taxes should be defended and attacked in terms of their effects on the character of American life, not as revenue measures.

The third reason for federal taxes is to provide a subsidy for some industrial or economic interest. The most conspicuous example of these taxes is the tariffs on imports. Originally, taxes of this type were imposed to serve a double purpose, since, a century and a half ago, the national government required revenues in order to pay its bills. Today, tariffs on imports are no longer needed for revenue. These taxes are nothing more than devices to provide subsidies to selected industries; their social purpose is to provide a price floor above which a domestic industry can compete with goods produced abroad and sold in this country more cheaply except for the tariff protection. The subsidy is paid, not at the port of entry where the imported goods are taxed, but in the higher price level for all goods of the same type produced and sold at home.

The fourth purpose served by federal taxes is to assess, directly and visibly, the costs of certain benefits. Such taxation is highly desirable in order to limit the benefits to amounts which the people who benefit are willing to pay. The most conspicuous examples of such measures are the social security benefits and old-age and

unemployment insurance. The social purposes of giving such benefits and of assessing specific taxes to meet the costs are obvious. Unfortunately and unnecessarily, in both cases, the programs have involved staggering deflationary consequences as a result of the excess of current receipts over current disbursements. When peace comes, these programs must be corrected so that the stability of the dollar will not be impaired by the financial consequences of excessive social security receipts or disbursements.

4. *Tax Consequences*

The federal tax on corporation profits is the tax that is most important in its effect on business operations. There are other taxes which are of great concern to special classes of business. Many problems of state and local taxation of business become extremely urgent, particularly when a corporation has no profits at all. However, we shall confine our discussion to the federal corporation income tax, since it is in this way that business is principally taxed. We shall also confine our considerations to the problems of ordinary peacetime taxation, since, during wartime, many tax measures, such as the excess profits tax, have a special justification.

Taxes on corporation profits have three principal consequences—all of them bad. Briefly, the three bad effects of the corporation income tax are:

1. The money taken from the corporation in taxes must come in one of three ways. It must come from the people, in the higher prices they pay for the things they buy; from the corporation's own employees, in wages that are lower than they otherwise would be; or from the corporation's stockholders, in lower rate of return on their investment. No matter from which source it comes, or in what proportion, this tax is harmful to production, to purchasing power, and to investment.

2. The tax on corporation profits is a distorting factor in managerial judgment, a factor prejudicial to clear engineering and economic analysis of what will be best for the production and distribution of things for use. And, the larger the tax the greater the distortion.

3. The corporation income tax is the cause of double taxation. The individual taxpayer is taxed once when his profit is earned by the corporation, and once again when he receives the profit as a dividend. This double taxation makes it more difficult to get people to invest their savings in business than if the profits of business were taxed only once. Furthermore, stockholders with small incomes bear as heavy a burden under the corporation income tax as do stockholders with large incomes.

Let us examine more closely these three bad effects of the tax on corporation profits. The first effect we observed was that the corporation income tax results in either higher prices, lower wages, reduced return on investment, or all three in combination. When the corporation income tax was first imposed it may have been believed by some that an impersonal levy could be placed on the profits of a soulless corporation, a levy which would be neither a sales tax, a tax on wages, nor a

double tax on the stockholder. Obviously, this is impossible in any real sense. A corporation is nothing but a method of doing business which is embodied in words inscribed on a piece of paper. The tax must be paid by one or more of the people who are parties at interest in the business, either as customer, as employee, or as stockholder.

It is impossible to know exactly who pays how much of the tax on corporation profits. The stockholder pays some of it, to the extent that the return on his investment is less than it would be if there were no tax. But it is equally certain that the stockholder does not pay all of the tax on corporate income—indeed, he may pay very little of it. After a period of time, the corporation income tax is figured as one of the costs of production and it gets passed on in higher prices charged for the company's goods and services, and in lower wages, including conditions of work inferior to what they otherwise might be.

The reasons why the corporation income tax is passed on, in some measure, must be clearly understood. In the operations of a company, the management of the business, directed by the profit motive, keeps its eyes on what is left over as profit for the stockholders. Since the corporation must pay its federal income taxes before it can pay dividends, the taxes are thought of—the same as any other uncontrollable expense—as an outlay to be covered by higher prices or lower costs, of which the principal cost is wages. Since all competition in the same line of business is thinking the same way, prices and costs will tend to stabilize at a point that will produce a

goal-profit, after taxes, sufficient to give the industry access to new capital at a reasonable price. When this finally happens, as it must if the industry is to hold its own, the federal income tax on corporations will have been largely absorbed in higher prices and in lower wages. The effect of the corporation income tax is, therefore, to raise prices blindly and to lower wages by an undeterminable amount. Both tendencies are in the wrong direction and are harmful to the public welfare.

Suppose the corporation income tax were removed, where would the money go that is now paid in taxes? That depends. If the industry is highly competitive, as is the case with retailing, a large share would go in lower prices and a smaller share would go in higher wages and in higher yield on savings invested in the industry. If labor in the industry is strongly organized, as in the railroad, steel, and automotive industries, a large share would go in higher wages. If the industry is neither competitive nor organized nor regulated—of which industries there are a few—a large share would go to the stockholders. In so far as the present corporation income tax tends to reduce wages and dividends, the higher wages and dividends that would result from the elimination of this tax would be subject to individual income tax for each individual in his highest bracket. In so far as the elimination of the present corporation income tax would result in lower prices, it would raise the standard of living for everyone.

The second bad effect of the corporation income tax is that it is a distorting factor in management judgment, entering into every decision and causing actions to be

taken which would not have been taken on business grounds alone, and the larger the tax the greater the distortion. The tax consequences of every important commitment have to be appraised. Sometimes, some action which ought to be taken cannot be taken because the tax results make the transaction valueless, or worse. Sometimes, apparently senseless actions are fully warranted because of tax benefits. The result of this tax thinking is to destroy the integrity of business judgment, and to set up a business structure and tradition which does not hang together in terms of the compulsions of inner economic or engineering efficiency.

The most conspicuous illustration of the bad effect of tax consideration on business judgment is seen in the preferred position that debt financing has over equity financing. This preferred position is due to the fact that interest and rents, paid on capital used in a business, are deductible as expense; whereas dividends paid are not. The result weights the scales always in favor of debt financing, since no income tax is paid on the deductible costs of this form of capital. This tendency goes on, although it is universally agreed that business and the country generally would be in a stronger position if a much larger proportion of all investment were in common stocks and equities, and a smaller proportion in mortgages and bonds.

It must be conceded that, in many cases, a high corporation income tax induces management to make expenditures which prudent judgment would avoid. This is particularly true if a long-term benefit may result, a benefit which cannot or need not be capitalized. The

long-term expense is shared involuntarily by government with business, and, under these circumstances, a long chance is often well worth taking. Scientific research and institutional advertising are favorite vehicles for the use of these cheap dollars. Since these expenses reduce profits, they reduce taxes at the same time; and the cost to the business is only the margin of the expenditure that would have remained after the taxes had been paid—the government pays the rest. Admitting that a certain amount of venturesome expenditure does result from this tax inducement, it is an unhealthy form of unregulated subsidy which, in the end, will soften the fiber of management and will result in excess timidity when the risk must be carried by the business alone.

The third unfortunate consequence of the corporation income tax is that the same earnings are taxed twice, once when they are earned and once when they are distributed. This double taxation causes the original profit margin to carry a tremendous burden of tax, making it difficult to justify equity investment in a new and growing business. It also works contrary to the principles of the progressive income tax, since the small stockholder, with a small income, pays the same rate of corporation tax on his share of the earnings as does the stockholder whose total income falls in the highest brackets. This defect of double taxation is serious, both as it affects equity in the total tax structure and as a handicap to the investment of savings in business.

Any one of these three bad effects of the corporation income tax would be enough to put it severely on the defensive. The three effects, taken together, make

an overwhelming case against this tax. The corporation income tax is an evil tax and it should be abolished.

5. *No Refuge*

The corporation income tax cannot be abolished until some method is found to keep the corporate form from being used as a refuge from the individual income tax, and as a means of accumulating unneeded, uninvested surpluses. Some way must be devised whereby the corporation earnings which inure to the benefit of individual stockholders are fully taxed as income of these individuals.

The weaknesses and dangers of the corporation income tax have been known for years, and an ill-fated attempt to abolish it was made in 1936 in a proposed undistributed profits tax. This tax, as it was imposed by Congress, had four weaknesses which soon drove it from the books: First, the income tax on corporations was not eliminated in the final legislation, but the undistributed profits tax was added on top of it. Second, it was never made absolutely clear, by regulation or by statute, just what form of distributed capitalization of withheld and reinvested earnings would be taxable to the stockholders and not to the corporation. Third, the Securities and Exchange Commission did not set forth special and simple regulations covering securities issued to capitalize withheld earnings. Fourth, the earnings of a corporation were frozen to a particular fiscal year, with none of the

flexibility of the carry-forward, carry-back provisions of the present law.

Granted that the corporation income tax must go, it will not be easy to devise a tax substitute which will be entirely satisfactory. The difficulties are not merely difficulties of technique and of avoiding the pitfalls of a perfect solution impossible to administer, but are questions of principle that raise issues as to the proper locus of power over new capital investment.

The suggestions which have been made follow three patterns: First, a modification of the English scheme, which allows the individual taxpayer credit, on his own tax, for what has been paid by the corporation on his share of the corporation's distributed earnings. Second, a modification of the mandatory undistributed profits tax. Third, the use of scrip or other evidence of withheld earnings, which would be taxable to the stockholder and could be used by him to pay his tax.

Without going too far into technical detail, the basic points in these three classes of proposals are fairly clear:

1. The English scheme would avoid double taxation on distributed earnings. However, it would not free business management of tax considerations in management decisions, it would not get the corporation income tax out of prices and wages, and it would not bring pressure for the distribution of corporate earnings. A variant of the English scheme is vastly to be preferred to the present system. It is relatively simple, but it solves only a small part of the total problem, and it should not be accepted until efforts for a more comprehensive solution have failed.

2. Modifications of the old undistributed profits tax are

suggested by those who believe that the money market and the stockholders of a company are better judges than the management as to what should be done with current earnings. These people say, "Distribute the earnings! Let the stockholders decide whether or not they should be reinvested." It is contended that management will always be too close to its own operations to judge the relative desirability of the reinvestment of current earnings as against new investment in other companies, or, for the stockholder, expenditure on current personal needs. Accordingly, the suggestion is made that a large proportion of current earnings, 70% or 80%, be distributed in cash. If the management feels that new capital is needed, it should go to the regular sources of capital and apply for it.

It seems improbable that any solution which turns the managers of business to the money market, as a matter of necessity, will be acceptable. There is some force in the argument that the stockholders should have the right to decide, each year, what they want to do with their own earnings. But it is doubtful that this privilege will be granted if the result will be to place the management of business in the hands of financial institutions and the money market, making them its exclusive source of new capital.

3. A third group of suggestions is based on distributing to the stockholders all, or nearly all, the earnings of a corporation, permitting the distribution to be either in cash or in some type of company security or scrip which would be taxable as income to the stockholder, and which he could cash or use to the extent needed to pay the income tax due from him.

A plan of this kind differs from that in the second group in one important respect: the decision as to whether earnings should be reinvested in the company remains with the management, where it is today. The only important difference

from present practice would be that the stockholder would receive some sort of bond, stock, or scrip from the management. It does not seem too much to ask the management of a business to give its stockholders from time to time a receipt for the undistributed earnings which have been plowed back into the corporation.

A plan of this third type would meet most of the problems we want to solve: each taxapayer would be taxed for his share of the corporation's earnings at his individual income tax rate; the company could withhold as much of the earnings as it deemed wise, provided they were capitalized; and the stockholder would have the means to pay his tax. It only remains to invent a security, of the kind described, that will be practical in operation.

In the report on fiscal and monetary policy which Mr. H. C. Sonne and I made to the Business Committee of the National Planning Association, we suggested a 5% tax on corporate profits, which would represent the value of doing business in the corporate form; a 16% tax on undistributed profits; and a continuation, for the time being, of the present tax of 25% on long-term capital gains. Although such a proposal lacks complete logical justification, nevertheless, it has the advantage of simplicity.

Other provisions, such as strengthening Section 102 of the present Revenue Act, restrictions on personal holding companies, and other protective measures, should be drawn to close loopholes for individual income tax avoidance, and building up unneeded surpluses.

It is my opinion that a 16% tax on undistributed profits would tend to cause corporations having easy ac-

cess to the capital markets to finance their capital requirements rather than withhold earnings, and that a tax of 16% will not be an undue burden on corporations which otherwise would have to pay a selling commission to raise additional capital funds.

The sum of the 16% tax on undistributed profits, and the 25% tax on capital gains, seems to me to be a sufficient tax on the individual who realizes his profits from the operations of a corporation, not in income distributed to him as dividends, but in the sale of his securities at a price higher than his original investment.

Can the government afford to give up the corporation income tax? That really is not the question. The question is this: Is the corporation income tax a favorable way of assessing taxes on the people—on the consumer, the workers, and the investors—who after all are the only real taxpayers? It is clear from any point of view that the effects of the corporation income tax are bad effects. The public purposes to be served by taxation are not thereby well-served. The tax is uncertain in its effect on the stabilization of the dollar, and it is inequitable as part of a progressive levy on individual income. It tends to raise the prices of goods and services. It tends to keep wages lower than they otherwise might be. It reduces the yield on investment and obstructs the flow of savings into business enterprise. The elimination of the corporation income tax from the tax system will increase the effectiveness of our fiscal and monetary policies and, by broadening markets for goods and services, will strengthen business for its task of producing goods, pro-

viding employment, and giving the people a place where their savings can be invested.

If we have no sales tax, no corporation income tax, and eliminate most of the excises, will we not have to put an intolerable burden on the individual income tax? The answer is "no." Under the tax policy which we have suggested, the individual income tax can be reduced by an aggregate of 30% and still we can balance an 18 billion dollar budget at high employment. A 30% cut from the present income tax is a substantial reduction. But there are some people who want more. They feel that a 66% top rate is too high and that a $500 exemption for dependents is too low. They would use the invisible and widespread burden of the corporation income tax on the standard of living to enable them to give alternatively visible and specific benefits in higher exemptions for dependents and lower surtax rates, benefits that will not increase the purchasing power of the poor except perhaps at second or third hand.

Personally, I agree that for the long pull and in an orderly world, the high bracket rate of 66% is too high and the $500 exemption is too low. But we are not yet in an orderly world. Provision of five billion dollars in a peacetime budget for armament is a symptom of this disorder. When peace is at last organized, and this item can be cut in half, then we can reduce rates and increase exemptions in the individual income tax to reasonable levels that we might be willing to live with.

For the present, I think we should be satisfied with a 30% cut in the individual income tax. We should avoid the use of indirect regressive taxation such as the corpora-

tion income tax, although it can probably be made politically acceptable. In this program, business and labor have a common interest because of their common interest in the achievement and maintenance of a high level of employment.

XI

Fiscal Policy, Public Works. and the Construction Industry

1. Fiscal Policy and Public Works

WE have seen that in a fiscal policy devised to help keep private business healthy, two aspects of great concern to business are taxation and public works. For that reason, we have felt it appropriate to examine these subjects in some detail. In this chapter we shall consider public works as a part of fiscal policy, and shall look into its possibilities as a means of strengthening the construction industry.

When public governments build things, private business is affected at three important points:

First, as we have said, business depends for its best accomplishment on a high and relatively even flow of purchasing demand; and public expenditure on public works makes a contribution to the increase of purchasing power.

Second, the character of the public works themselves may decrease or increase the amount of private business

activity. If the public works appear to offer subsidized competition in an area in which private business has an interest, new private investment will be held back. On the other hand, if we improve the common facilities—such as the mails, water systems, and highways—business will be stimulated by these improvements to activity and investment.

Third, public works have an immediate and direct effect on a particular segment of business, the construction industry. Public works use the same kinds of materials and labor as are used by private businesses and individuals when they build, and, in most cases, public works are built on contracts let to private construction businesses and contractors.

The great monuments of antiquity and of the Middle Ages have always had a peculiar fascination for economic planners. The palaces of Assyria, the pyramids of Egypt, the highways and aqueducts of Rome, the cathedrals of Europe, all represent the ideal public project for which it seems so difficult to invent the contemporary parallel. These works seem to have been acceptable by the community as worthy objects of effort, they were vast in scale relative to their times, and they created no awkward product that would have to be sold in the market place. Being visible and tangible, they proved to be contagious examples to other states and rulers. Work on these monumental projects extended off and on over hundreds of years of time, and required the application of hundreds of millions of man-hours to complete—if, indeed, any of them were ever truly completed.

During the depression of the 1930's we came to have

a profound disillusionment with respect to the use of public works as a means of sustaining business activity. For ten years previously the idea had been current in government and business circles that the planning and scheduling of public works would afford a practical offset to the ups and downs of the business cycle. When the breakdown came in 1929, nothing of a practical nature had been done to make it possible to put such an idea into action. At last, after the depression had run for two years and was growing deeper and deeper, the Employment Stabilization Act of 1931 was passed, and the Employment Stabilization Office was established in the Department of Commerce. It was, of course, impossible for this new agency, at this late day, to do much to check the downward plunge—and soon the Office was allowed to dry up.

In the spring of 1933, in what was thought to be a bold attempt to produce recovery, an appropriation of $3,300,000,000 was made for public works as part of the National Recovery Act of 1933. By the fall of 1933, it became apparent that public works could not be started by wishing, or even by appropriating money. Public works require long and detailed planning, legal investigations, and, in many cases, enabling legislation by state and local governments. To meet the urgent need for employment, the Civil Works Administration was hastily put together late in 1933, and this was followed by the Works Progress Administration and later by the Work Projects Administration. These emergency agencies provided enormous amounts of employment at federal expense, but, for the most part, they did not carry on "pub-

lic works" of the sort that met the standards of efficiency and necessity that public works officials like to be associated with. Many projects, devised in desperate haste to provide work of some kind for particular classifications of unemployed talent at particular locations, were subjected to public ridicule and abuse. The program was admittedly "public work" rather than "public works," and, although many of the undertakings could meet the test of necessity and desirability, they broke down on the test of efficiency and reasonable cost.

The idea of using standard public works as a way of supporting purchasing power in time of depression had failed. The record of federal public works as a means of overcoming a depression during the 1930's was a disappointing one. It was disappointing because we had been led to expect too much, and because, during the years preceding the depression, the necessary preparatory work had not been done. Our disappointment should not cause us to reject the use of public works as one of the means of supporting the level of private business, but it should make us revise our expectations and improve our planning and scheduling.

The experience of the 1930's with public works taught us many things. Above all, it taught us that the scale on which public works must be pressed in order to do any good in a period of unemployment is vastly greater than we had been led to believe. Indeed, it is so vast that the use of public works as a means of stabilizing the whole economy through the phases of a business cycle may well be abandoned. The most we should expect—and this is no small gain—is that we may be able, with

public works, to stabilize the construction industry itself so that it would have a more even level of activity throughout the year and over the years.

In addition to magnitude and administrative difficulties, there is another reason for abandoning the idea of using public works as a general cure-all for the business cycle. This other reason is the human undesirability of bringing hundreds of thousands of men into the construction industry and forcing them out again as an offset to the free play of economic forces elsewhere in the business system. These men are not statistical units which can be properly moved from one column of an accounting sheet to another in order to preserve a balanced level of employment. Nor can they be shifted long distances from their homes to places and at times convenient to the business cycle.

The more limited ideal of using public works to help stabilize the construction industry itself is, therefore, indicated both by the magnitude of the operation and by the human considerations of regularized employment. These considerations lead us to the further conclusion that we should attempt this stabilization, not only for the country as a whole, but also regionally. The full requirements of stability will not have been met unless the overwhelming majority of the workers in the construction industry are able to spend at least two days a week at home every week. This means that the planning and scheduling of public works must be done in both financial and geographic terms.

What level of employment in the construction industry should we set as full-time normal for a long-time

program? The suggestion has been made that we might take as a rough standard the average rebuilding of our physical plant once a generation, say once in thirty years. This suggestion has the appeal of picturing each generation turning over to the next generation new, modern structures instead of old, outmoded houses, schools, and factories. Rough estimates indicate that such a program would require about 8% of the annual national product and would keep 6,500,000 men employed on and off site.

It is important to have some such standard, also to indicate how far we ought to go in bringing forward the scheduling of public works planned for construction at times when private demand is extremely high. It is likely that immediately following the war, and for some years thereafter, we shall have a considerable boom in private residential building. It may well be that this boom, together with industrial demands and public works which cannot be postponed, will be more than sufficient to carry the construction industry to or beyond the level that we may have agreed we would maintain as a long-time standard normal. If this should happen, and if at the same time there should be substantial unemployment, there would be a temptation to accelerate postponable public works, even though a full quota in the construction industry had already been reached. Barring local situations and public works actually urgently needed for public safety and welfare, it would be wiser to hold back public works, in spite of the presence of some unemployment. There are other effective weapons which can be used to fight unemployment, and it would only make the business outlook worse to create

so high a level of employment in the construction industry that it could not be maintained, a level that would say to all who could hear, "Crisis ahead!"

A second lesson which has been learned as a result of the experience of the 1930's is that the public will not tolerate expenditure by the government that it believes to be wasteful. Leaf-raking and boondoggling are condemned by public opinion, and even the inefficiency which results from the employment of the incompetent unemployed or from the failure to use known labor-saving equipment is frowned upon. The public rejects the elaborate rationalization that some purchasing power is better than none. The argument that public boondoggling is neither better nor worse than private boondoggling is to no avail. The people will not accept wasteful public expenditure as an element in fiscal policy, nor will they approve the subsidy of projects which have not been recognized as suitable for public governmental support.

The insight of the people in this respect is sound. It is obvious that wasteful effort at public expense is done at a social cost. The justification that, had the labor been unemployed, nothing at all would have been produced is unconvincing. Even though the waste be less, it is still undesirable. The people simply reply, "Why should there be waste? When so much need exists, how can we afford to fritter away these costs? Who bears the cost but we-the-people?"

The governmental agencies in charge of public works have always been sensitive to the public opposition to wasteful expenditure. Projects conceived and adminis-

tered primarily to provide work for particular groups of the unemployed were segregated in special temporary agencies such as the WPA, the CCC, and the NYA. This segregation of what was known to be more or less wasteful work enabled the Public Works Agency to confine its projects to items which would be justified on grounds of merit and efficiency.

This public attitude toward wasteful expenditure, toward spending for the sake of spending, justifies the segregation of any necessary work relief activities from public works proper. It also makes imperative the preparation of detailed plans and specifications on optional public works projects in an adequate amount. The necessary authorizations, appropriations, and legal considerations should be taken care of. Necessary negotiations between federal government, state, and local authorities should be completed. Only after a substantial number of projects so prepared are available can business feel that an acceptable public works program is a practical possibility.

The preparatory work so necessary for proper timing and for the avoidance of waste cannot be done unless there is a national policy on the purpose, scope, and scale of the federal public works program. Any program which is geared to make a decisive contribution, even to the stabilization of the construction industry, requires a scale of advance planning far beyond anything now being carried forward. It is true that today, at all levels of government, active engineering and architectural preparations are going on for postwar public works; but these plans are not associated in any over-all view, nor

are they projected against national or regional requirements for stabilization.

There is another reason why purpose, scope, and scale of public works programing should be under public discussion. It is desirable that the public should appreciate the magnitude of the program and should approve it well in advance of the time when detailed operations will have to begin. Only in this way can true economy of expenditure be attained. The magnitude of any construction stabilization program, over a period of twenty years, would permit dramatic changes in our national physical plant. Unless there is some comprehensive concept of what is attainable, there will be great waste through the undertaking of thousands of unrelated efficient details. This is not a justification for a formalized, unified, and imposed national public works straitjacket into which the future public construction of the country will be tied. It is simply an observation that the whole is greater than its parts, and that many a poor cake has been made from worthy ingredients.

2. *The Construction Industry*

The construction industry is greatly involved in public works expenditure, no matter what our policy on public works may be. And the construction industry is a costly and a wasteful industry.

The industry as a whole is well-pictured in the lyric

of a song favorite of the 1930's: "I built a building to the sun, finished ahead of time. I built a building, now it's done. Brother, can you spare a dime?"

Every phase of the industry is subject to the feasts and famines of seasonal and cyclical demand. The circumstances which cause one family to decide to build a home cause thousands to decide the same way at the same time. The circumstances which result in a profitable outlook for the building of a factory by one company will simultaneously affect thousands of companies. When families and businesses cannot or do not wish to build, broad general causative factors are at work which create a generally unfavorable climate for construction.

The private construction industry has tried to adapt its practices so that the elements of the industry could survive under these adverse conditions. Architects, building contractors, building supply companies, labor, finance and mortgage companies, all found it necessary —each in its own way—to establish and to hold a price structure high enough so that the days and hours of activity would pay for the time when there was far less than enough to do.

This kind of pricing seems sensible enough, but in practice it presents some difficulties. In the first place, it takes the cost of idle time and adds it to the cost of active time, so that the active time carries a heavy total expense. In the second place, no such price schedule can be established and held unless outsiders are kept from coming into the industry, and unless insiders understand more or less specifically what the rules of the game are and it is made "convenient" to follow them.

The reasons why restrictive conditions spring up in so volatile an industry as construction are easy to understand. In periods of activity prices are well above actual expenses at the moment, and an outside interest, contractor, or worker might be satisfied to take a narrower margin for a short run, or to deliver a full day's work, or otherwise by competition to take income from an established member of the industry. The days of famine in the industry are supported by these days of feast, and the banquet—when it comes—must be reserved for the hungry home folks, not for the minstrel who will sing for his supper and then wander on.

In periods of dullness, there is always some small amount of construction which has to be done, and now the insiders must be held in line. Every element in the industry would prefer some little income to none at all, and active bidding for the business at lower prices might be expected. But this cannot be permitted. The price schedule must be kept up in order to make sure that when the activity comes again the income then received will be sufficient to provide a little more than a break-even for busy and idle time taken as a whole.

It is not necessary to recite in specific detail the restrictive practices for which the construction industry is notorious. All these practices spring from a common need, to make sure that the scale of prices obtained at times when there is work to do is sufficient to pay for the idle time too. Special instances of price maintenance are illustrated in the high costs which come from dragging out the work, or from limitation of output, or from unnecessarily short working days and weeks.

The high schedule of prices is forced higher still by the uncertainty of how long will be the periods of idleness which must be covered. A retailer knows that spring and winter comes every year and he can, therefore, figure his annual costs. In construction, who knows how long a boom may last, or when it may come again?

The organization of the industry to maintain a price structure provides an organization which can do other things as well, which can hold down "unfair" competition in matters other than price, which can see to it that available work is obtained by the right contractor, which can co-operate with municipal authorities to make sure that building codes give the industry the protection it feels it deserves. Co-operation between management and labor results in understandings of far-reaching importance in the elimination of competition all around.

The restrictive measures in the industry are in many cases ingenious, in some cases illegal, in all cases for the purpose of price maintenance and the control of competition. Similar restrictive practices in other countries are not illegal at all; in fact, in some instances the government co-operates in enforcement of agreements which in the United States are a penal offense.

In spite of extenuating circumstances, it is unwholesome to go along indefinitely with an industry which, for its own survival, has to have a considerable element of the outlaw in it. As long as illegal practices are condoned on the front of restrictive and collusive rules, they will be excused wherever they can be exploited to make a profit or to fortify a power position. Then, too, tolerance of illegal practices leads to a special kind of co-

operation between government, labor, and business—the cost of which is paid for by the consumer-citizen, both in high prices and in the corruption of his government.

Therefore, for many reasons, the stabilization of the construction industry through the planned timing of public works can be confidently expected to yield important benefits. First of all, construction costs should fall sharply and earnings of workers and profits of contractors should increase. Second, stability of employment should eliminate the uncertainties and fear which make the industry irresponsible, always fighting for its life. Third, the total public construction program could be well-planned. Certainly a stabilized industry would produce a vastly greater quantity of construction output and, over a period of time, would change in a fundamental way the structural American environment. Obsolete buildings could not stand before the march of an efficient construction industry.

At this point we meet a real difficulty. It would be impossible to justify large public expenditures today to support the construction industry at a high stabilized level operating under existing practices. Nor is it likely that the construction industry will change on its own initiative. In fact, a commitment on the part of the federal government to see that a high level of construction is held year after year would tempt into the industry a new following which would leave the industry on a stabilized level, to be sure, but with all elements only partially employed and with costs as high as ever. The government and the public would still not be getting their

money's worth, and the industry would still be pricing for idle time.

A program for stabilizing the construction industry through the use of public works should be accompanied by a Congressional investigation of the industry with recommendations that would result in its reorganization. Such an investigation should be of the same dignity and competence as that of the National Monetary Commission following which the Federal Reserve System was established. If it should be found that the industry requires certain immunities under the Sherman Act and state antitrust laws, it should be subject to corresponding regulation. If some of the restrictive practices of the industry should be continued, even under high stabilized production, these should be sanctioned by law and supervised by an appropriate regulatory body. Take, as an example, the situation in construction employment, once a regular year-around job is assured for the worker who makes good. Every trade school in the country would start turning out boys and girls competent to take jobs in this easy-to-learn industry. It is obvious that entry into the industry by workers would have to be limited, but the authority for the administration of these limitations could not be given over to the unions, nor could it be given to management and unions working together. The government would have to set the basic ground rules, covering the qualifications and the numbers which might gain admission to a given trade at a given time.

It is also possible that, after the industry is stabilized, entry into the industry as a contractor would be subject to public control. The number of contractors in

a given community might be limited to a number which would provide healthy competition and, at the same time, guarantee full-time employment to a minimum working force. The number of radio broadcasting stations in a community is limited by government licensing to the number that can serve the community without wave-band interference and other disorders which would come with irresponsible opening of broadcasting facilities.

The construction industry stabilized by public works expenditures, and regulated by a government agency, would be a different industry from what it is today. It would still be competitive, just as the radio or the banks or the airlines are competitive; it is possible that the industry would be even more competitive than it is today. Certainly the dominant factors in the industry would turn to innovations and economies as their way of bidding for a larger section of the construction pie. And, since the size of the pie is assured, who will complain if the quality is improved?

An industry that is looked to for 8% of the national product is certainly a matter of national concern, particularly when the industry cannot stabilize itself without resorting to inefficient restrictive practices which increase costs, postpone innovations, and introduce elements of lawlessness into the industry. When, added to these considerations, the industry is indispensable as a source of essential public works, of housing and transportation, and as an outlet for the investment of the people's savings; when it is to be the beneficiary of billions of dollars of planned public expenditure over the

years, it is certainly discussable that the industry should have quasi-public utility status. In any case, the industry should be given a chance under the law to reorganize for the most efficient service to the community as a private, competitive construction industry.

Now is a particularly good time for a Congressional inquiry into the needs of the construction industry. There is no nation-wide scandal to obscure real problems and result in distorted legislation. Further, the period immediately following the war will probably see the industry in a fairly healthy condition as far as demand is concerned. During this period the investigation could go on without the presence of crisis in the industry, forcing premature judgments.

It might well be that the 1940's will be the decade of the construction industry, the period when it grew out of unregulated anarchy into an orderly pattern of effective competition. Just as the railroads in the 1880's, the banks in the 1900's, and the security exchanges in the 1930's were recognized and regulated in the public interest, so the pattern of the construction industry may be redrawn in the years immediately ahead—a pattern that will give stability and order to the industry, efficiency and lowered cost construction to the public, and sound public works programing to the federal government.

XII

Fiscal Program

BUSINESS wants a fiscal program which will help it create good products, good jobs, and good investments. Business does not expect fiscal policy to do the work of business for it. Business only asks for a flow of purchasing demand which will have some general correspondence to what business is able to produce and distribute.

There will be much difference of opinion on details, but the main outlines of a program seem to be fairly clear.

First, let us have a national expenditure budget that fairly represents the national purposes we want to accomplish. Let us base our estimates on the efficient carrying out of these worth-while activities. We want no spending for its own sake, and no projects merely because they support purchasing power in general.

Second, let us set our rates of taxation so that they will produce enough revenue to balance the budget at some agreed level of high employment. We do not want a deflationary tax program at times of mass unemployment.

Third, having set our tax rates to balance the bud-

get at high employment, let us let them alone. When employment goes beyond this level, or if there is a boom in prices, let us use the surplus to reduce the national debt, not as an excuse for further tax reduction.

Fourth, let us hold on to our progressive income taxes and estate taxes as the best way of reversing the tendency of purchasing power to come to rest. Let us reduce the rates on the individual income tax to stimulate consumption and to make possible investment in new enterprise on a business basis.

Fifth, let us plan our public works, not to balance the whole economy, but to stabilize the construction industry. Our objective should be to provide in this basic industry continuous activity on an agreed level throughout the year and over the years. This would require advance planning of public works—federal, state, and local—scheduling, and the holding back of a large reserve of optional projects.

Sixth, let us reform the social security programs as far as their fiscal influences are concerned. Since their beginning they have been highly deflationary. For old-age security, let us set our rates and benefits so that they come somewhere near balancing; and for unemployment insurance, let us set our rates so that intake and outgo balance at high levels of employment as it may be defined.

Seventh, let us keep the important excise taxes for the time being, and get rid of the rest, except when they serve some social purpose. If employment and production lag overmuch, let us get rid of these too, since they are deflationary. We need no general sales tax for fiscal

policy purposes now that the individual income tax is on a current basis.

Eighth, let us plan our lending abroad, whether for stabilization, relief, or long-time reconstruction, so that it will support rather than contradict fiscal policies adopted to strengthen our domestic economy.

Ninth, and indispensably, let us press for a reorganization of the parts of the federal government which have to do with fiscal policy and administration. We want clarity in policy, unity in administration, and co-operation between the executive and legislative branches. Having arrived this far, we then want an adequate degree of co-ordination between federal, state, and local governments as their tax and expenditure policies affect national fiscal policy itself. We shall expect that unity of fiscal and monetary policy will be attained along the way.

This nine-point program raises some questions, but if the program makes sense, there are no constitutional or technical reasons why it could not be adopted to be ready once peace is declared and we are able to begin to resume our peacetime way of life. During the transition period, the nine-point program itself cannot be expected to eliminate the need for public expenditure for relief and rehabilitation; but it will provide a flow of purchasing demand which springs authentically from the tens of millions whose tax burdens will have been reduced. It expresses in the mosaic aggregate the popular interpretation of the American way of life as pictured in consumer preferences. Against this background, the readjustments of employment and the reconversion of business and industry can readily occur. I have remarked

elsewhere, "Why not leave at home, for expenditure by the individual, money that would have to be pumped out again in order to sustain employment?" The nine-point program is a way of carrying out the policy implied in this simple question.

FINALE

BUSINESS AND FREEDOM

Finale

THIS book has been concerned with business as an instrument of authority and power, as a source of direction and decision. We have found that the business of business in getting things ready for use at the same time gives people something useful to do and provides a place where the savings of people can be put to work.

Business gets these things done by making rules, enforcing them when it can, and compromising with them when it must, all with the sanction of public law. Business, therefore, is private government, since it is empowered by the state to organize and to make rules for the conduct of its affairs.

Business is but one government among many. Yet through it, as through others, we derive certainty and order; and in it, as in others, we must achieve personal dignity and freedom.

In this book we have studied the purpose and the structure of business rule-making power, and the relations of business to other rule-makers. We have identified the governed.

We have examined a number of critical points which determine the capacity of business to make its unique contribution to the freedom of those who are ordered by its rules, among these points, national fiscal policy, including taxation and public works.

Now, in our own time, although a common moral objective has not yet been generally accepted, the moral issues of freedom have been drawn again, and World War II has divided the world so that these issues no longer can be evaded. The issues are old ones, centuries old. Are human beings, all human beings, human? Are they created equal in their rights to life, liberty, and the pursuit of happiness? Are they entitled to achieve freedom? Do they stand, as persons, above race, sex, creed, and nationality? Are the governments which are instituted among men—governments public and private—ends for themselves alone? Or are they the means of providing a frame of order within which the dignity and worth of each human personality may be actualized through responsible freedom of choice?

Today, the issue is drawn between coalitions of national states in a war of survival. The victory of the United Nations will set as a world objective the achievement of human individuality through the exercise of responsible freedom. Tomorrow, all governments must conform to this standard, and private business, among other governments, must find its way.

Without a conception of freedom, the direction of business in the future will be at best tentative and uncertain. The clichés of freedom may become the mask behind which the love of power will organize its new

exploitations. Not "freedom for business," but "business for freedom" must be the objective of business leadership as the operations of business are administered to attain its appropriate ends.

Business, like other private governments, will be expected to organize and to administer its rule-making in a way that is consistent with prevailing ideas as to what the impulse to freedom demands. The business of business will continue to be the getting ready of things for use, the giving to people something useful to do, and the providing of a place where the savings of people can be put to work. But the rules of business, whereby business gets these things done, must set a frame of order within which freedom is the more attainable. Those who are governed by business—customers and suppliers, employees and stockholders—will expect to find in the operations of business a measure of the freedom for which "governments have been instituted among men."

It is true that most businessmen look on their businesses as profit-making, productive enterprises, and ordinarily do not think of themselves as rule-makers or of their businesses as rule-making agencies. But, since these businesses are both producers and rule-makers and must be run as both, they must be understood as both. The business manager who correctly appraises his role as governor of a private state, who knows the range of those affected by his rules, who appreciates the vitality in the impulse to freedom, and who understands what is needed to attain it, will make the detailed application of principle that conditions require and circumstances permit. The rate of progress will depend on insight and in-

genuity, pressure from within and without, examples of success and failure. Stubborn conservatism will be offset by reckless experimentation. In the meantime, the climate of world political opinion will hasten or retard the shifts in private business rule-making.

The resurgence of doctrines of human freedom during World War II will have its inescapable impact on business, particularly in the United States where the tradition of the American Revolution has high prestige. Fortunately, business in the United States is in a good position to move into the future harmoniously with the renewed impulse to freedom. After all, private enterprise is the twin of responsible individuality.